CORPORATE RESPONSIBILITY

SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

TOM BOSTOCK

Introduction

A noteworthy feature of the Committee's terms of reference is the use throughout of *corporate responsibility* (**CR**) instead of the more usual expression *corporate social responsibility* (**CSR**). Perhaps that is because the Committee shares the perception that the word *social* sucks out of the words *corporate responsibility* any objective meaning that they might otherwise have: see the first of the general submissions below.

It does, however, suggest a simple way of summarizing the essential thrust of this submission by making a distinction between:

- *corporate responsibility* (**CR**), which requires corporate decision-makers to ensure that their company complies with its legal obligations to "stakeholders" other than shareholders, whether imposed by law or assumed by contract or in any other way, and permits them to have regard to the interests of such "stakeholders" beyond the extent of legal obligation, so long as they believe reasonably and in good faith that it is in the interests of the company and the general body of its shareholders to do so; and

- *corporate social responsibility* (**CSR**), which would require or allow corporate decision-makers to direct their company to operate in the interests of "stakeholders" other than shareholders beyond the requirements of law, even when to do so is **not** in the interests of the company and the general body of its shareholders, thereby subordinating the interests of shareholders to those of other "stakeholders".

The essential thrust of this submission is that:

- subject to the point made below on *Corporations* Act 2001 (**CA**) s181(1), CR, understood in the above sense, is perfectly consistent with the present framework of statute and general law; and

- the adoption of CSR, understood in the above sense, would:

    - require the present legal framework to be changed to allow corporate decision-makers to subordinate the interests of their company and the general body of its shareholders to those of non-shareholder "stakeholders"; and

    - lead inevitably to a decline in the profitability and competitiveness of Australian corporations to the detriment of Australians generally.

This submission commences with an outline of the present state of the law, after which are set out submissions on the Committee's specific terms of reference. The final part of the submission, dealing with the meaning – or lack of meaning – of CSR, and the implications and origin of CSR, are substantially reproduced from the writer's contribution to a debate on CSR with Dr Bill Beerworth, which was published in the December 2004 issue of *Company Director*.

The present position

Any discussion about CR or CSR is apt to go astray if it does not take as its starting point the incalculable debt owed by society to corporations. It is no exaggeration to attribute the unprecedently high standard of living and prosperity that most societies enjoy today above all to the development of the limited company over the last 150 years.

We must also remind ourselves that a limited company exists to pursue a business with the object of generating as high a return as business exigencies permit for its shareholders, who have contributed the capital without which the company would not exist. They are encouraged to contribute what is essentially risk capital by the risk-limiting principle of limited liability.

In pursuing that object, the company will also generate wealth for its employees, lenders, suppliers and other parties in meeting the demands of its customers. Ultimate responsibility for the success or otherwise of the company's business lies with its directors and managers, who can be seen as stewards for the capital-providing shareholders. The extensive fiduciary and other duties imposed on directors under the general law, and increasingly enlarged or supplemented by statute, are in general owed to the company as representing the general body of its shareholders.

It is important at this point to keep in mind that the shareholders, far from being in any position of privilege, are the most at risk should the company fail. In its liquidation, all they are entitled to is such of the company's wealth, if any, as remains after the company's liabilities to its creditors, be they employees, lenders, suppliers or other outside parties, have been meet. While a company remains in operation, the shareholders' return on their capital depends entirely on the profits earned by the company: no profits, no dividends.

It follows that the company's business under stewardship of its directors should be directed towards maximizing the return to its shareholders. That is the basis of company law as we know it. In pursuing that objective, the company must comply with its obligations to outside parties, whether assumed by contract or imposed by law. That is not to say that the company may not impose it upon itself obligations, such as for employee benefits, OH&S, product safety, the environment etc, over and above those imposed by law. On the contrary, the company is free to do so, but in doing so, the law requires its directors to be satisfied that it is in the interests of the company and its shareholders.

The importance of corporate profitability cannot be over-emphasized: on it depends the well-being not only of the outside parties already mentioned, but also of shareholders, whose number includes indirectly a vast number of superannuation fund members, life and general insurance policy holders, and the community generally through the generation of corporate tax revenue. The limited company is the instrument for converting the savings of a given community into the capital that generates the corporate investment that secures the general well-being of that community as nothing else can.

Submissions on the Committee's specific terms of reference

In the light of those observations, I venture to make the following submissions to the Committee on the issues specified in the Committee's terms of reference.

(a) *The extent to which organizational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.*

From the inception of the limited company a century and a half ago, the directors and others involved in the management of a company have been under the duty at law to act in good faith in the interests of the company as representing the interests of the general body of the shareholders who contributed the risk capital without which the company would not exist.

Fundamental to the performance of that duty, corporate decision-makers must exercise due care to ensure that the business of their company is carried on in accordance with or applicable requirements of law. In the context of non-shareholder interests, labelled – perhaps not altogether appropriately – as "stakeholders", in a company, that includes compliance with the requirements of laws and regulations governing such matters as workplace relations, occupational health and safety and environmental impacts.

If it is thought that those requirements are inadequate, it is the function of Parliament to amend the relevant legislation appropriately, as they are requirements which should apply equally to all business operations, whether carried on through an incorporated entity or not.

In short, corporate decision-makers must have regard for the interests of "stakeholders" at least to the extent that the law applicable to their company's business so requires. As will be seen from the submission on terms of reference (b), the present law gives corporate decision-makers a fair measure of leeway in having regard for the interests of "stakeholders" beyond that extent.

(b) *The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.*

A prevalent misconception, one which is probably the mainspring of the corporate social responsibility (CSR) industry, is that the duty to act in the interests of their company implies that corporate decision-makers need do no more for the benefit of non-shareholder interests than the letter of the law requires.

That has never been the law. As long ago as 1883, the correct principle was explained – in the characteristically trenchant language of the time – by Bowen LJ in *Hutton v. West Corp Railway Co* (1883) 23 Ch D at pp 672-3 thus:

> "It seems to me you cannot say the company has only got power to spend the money which is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company given to them by sect. 90 of the Companies Clauses Consolidation Act, are always to be limited to the strictest possible view of what the obligations of the company are. They are not to keep their pockets buttoned up and defy the world unless they are liable in a way which could be enforced at law or in equity. Most businesses require liberal dealings. The test there again is not whether it is bona fide, but whether, as well as being done bona fide, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit. Take this sort of instance. A railway company, or the directors of the company, might send down of the porters at a railway station to have tea in the country at the expense of the company. Why should they not? It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company, and a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond, would soon find itself deserted – at all events, unless labour was very much more easy to obtain in the market than it often is. The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."

The legal principle is expressed in Ford's *Principles of Australian Corporations Law* [8.130] in the following more contemporary terms:

> "The decided cases in this area indicate that management may implement a policy of enlightened self-interest on the part of the company but may not be generous with company resources where there is no prospect of commercial advantage to the company."

That formulation might conceivably be too generous when considered in the light of CA s181(1): see submission on term of reference (c).

(c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

The ability of corporate decision-makers to treat non-shareholder parties and interests more generously than required by the strict letter of the law, so long as to do so is in the interests of their company, was further enhanced by the general law doctrine that directors must act "bona fide in what they consider – not what the court may consider – is in the interests of the company.": *re Smith & Fawcett Ltd* [1942] Ch 304 at 306 per Lord Greene MR. In other words, even if a particular decision by the directors of a company turned out, as events unfolded, not to be in the best interests of their company, the directors could not be rendered liable for making it unless the decision were one that no reasonable board of directors would make.

That general law principle was, however, overturned in Australia by the enactment in 1999 of *Corporations Act 2001* (CA) s 181(1) in the Bill for the *Corporate Law Economic Reform Program Act 1999.*

As introduced into the Parliament s 181(1) provided:

(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith **in what they believe to be** in the interests of the corporation; and

(b) for a proper purpose

(emphasis added)

At the behest of the opposition parties in the Senate, the words "in what they believe to be" were deleted from s 181(1) as enacted.

The effect of deleting it "in what they believe to be" is to make a director's or other officer's belief as to what is objectively in the best interests of the relevant company inevitably the subject of review in hindsight by the court. That gives rise to the fundamental problem that every act or omission amounts to a choice, whether made consciously or otherwise, between at least two courses: to act or not to act; or to choose between two or more alternative actions, each of which might be in the interests of the relevant company. The choice can be made only on a subjective basis at the time of making it. Whether the choice made was in the best interests of the company in the objective sense required by the amendment can be determined only afterwards in the light of hindsight; and even then, it would be more a matter of opinion than fact.

It is perhaps unlikely that the momentous implications of that change were present to the minds of the politicians who made it, one of which is that the change could only reduce the ability of company decision-makers to confer benefits on "stakeholder" parties and interests beyond the strict requirements of the law. And the very making of the change almost certainly makes it impossible for a court to interpret s 181(1) as if the change had not been made.

Whatever else its consequences, the change made to s. 181(1) can operate only to make company directors and officers more cautious about conferring unmandated benefits on parties other than shareholders than they would have been had the change not been made.

(d) *Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community.*

It follows that, if the Committee believes that the ability of company decision-makers to act in the interests of non-shareholder parties beyond the requirements of law should be clarified or enlarged, the most obviously expedient way of doing so would be to amend s 181(1) by restoring the words "in what they believe to be".

That amendment would not only re-align s181(1) to the corresponding general duty, but would also make it run parallel with clause B.3(1) of the draft *Company Law Reform Bill* included in the *Company Law Reform White Paper* issued in March 2005 by the UK Department of Trade and Industry, under which:

> *(1) As a director of a company you must act in the way* ***you consider****, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.* (Emphasis added.)

As noted in section (a) above, if it is thought that the obligations of businesses in relation to – for example – the environment should be enlarged, the appropriate way to do so is by amending relevant environmental legislation applicable equally to all business operations, whether carried on through an incorporate or unincorporated entities.

(e) *Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.*

In view of the present state of the law, if CA s 181(1) were amended as submitted in section (d) there is in my submission ample ability or part of incorporated entities and their directors to advance "stakeholders" interests whenever it is in the interests of the relevant entity to do so.

(f) *The appropriateness of reporting requirements associated with these issues.*

The CA should not impose reporting requirements in relation to non-financial matters, but should leave it open to reporting entities to report on those matters to the extent and in the manner thought appropriate by their directors and management.

It has become more common than not for listed companies, particularly the larger ones, to include in their annual financial reports a section reporting on the company's self-perceived performance on so-called sustainability issues. Indeed, as the Committee would know, The Global Reporting Initiative (**GRI**) has produced its *Sustainability Reporting Guidelines* as "a common framework for sustainability reporting".

The GRI Sustainability Report sets out at great length and in great detail "indicators" for environmental and social "performance", compliance with which would, in the case of most companies at least, be very expensive. The incurring of such a cost – like any other expenditure of a company's funds – is justified only if it is in the interest of the relevant company to incur it. The main factor that would be raised in justification in the case of a sustainability report would be the belief that it will serve to deflect claims by non-shareholder interests which would or might have adverse effect on the company's business with even greater cost to the company.

In a real sense, therefore, a sustainability report amounts to self-serving propaganda, and is increasingly seen to be so by the constituencies to whom it is primarily addressed.

For example, in the context of the G8 Summit in July 2005, Meena Raman, Chair of Friends of the Earth International, was reported as saying:

> "The [corporations] speak of what they have done by way of corporate social responsibility, which is voluntary and non-binding. But we find these claims are "green washing", and much more of a public relations exercise."

That is a view which is taking hold in environmental and other groups in the sustainability industry. It may even be that a company would be less likely to attract the unfavourable attention of the sustainability industry by not producing a sustainability report at all. If, however, the directors of a company believe the best interests of the company would be served by making a sustainability report, they are, and should remain, free to do so.

At the same time, there can certainly be no justification at all to require by legislation or regulation any form of sustainability report.

(g) *Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.*

I am not aware of any regulatory, legislative or other policy approaches in any other country that could be usefully adopted or adapted for Australia.

General submissions

The meaning of corporate social responsibility

The threshold problem with CSR is working out what exactly it means. The difficulty lies with the word *social* which, as Hayek memorably observed, "can be used to describe almost any action as publicly desirable and has at the same time the effect of depriving any terms with which it is combined of clear meaning.": the perfect example of a weasel word, sucking out from the word it qualifies any real meaning, just as a weasel is said to suck out the contents of an egg. The problem would perhaps not matter if all that CSR is generally intended and understood to mean that a company's operations should be conducted in accordance with the requirements of law, and beyond those requirements where it is in the interests of shareholders to do so.

That, however, does not appear to be the intention of the promoters of CSR. For example, the World Business Council for Sustainable Development (WBCSD), an influential body whose 175 members include many of the largest MNE's, and a significant proponent of CSR, defines CSR as *business' commitment to contribute to sustainable economic development, working with employees, their families, the local community, and society at large to improve their quality of life*, an example of defining a meaningless term in meaningless terms, the word *sustainable* being as much a weasel word as *social*. It doesn't look like a party to which shareholders are invited.

As WBCSD itself acknowledges, "CSR means very different things to different people, depending on a range of local factors, including culture, religion, and governmental or legal conditions. There can be no universal standard." Seen in that light, CSR is scarcely a sure foundation on which company directors and managers could develop corporate policy or legislators could develop corporate law. Perhaps the essential meaninglessness of CSR is the cement that keeps together the strange coalition of its advocates. If that were all that were to it, CSR would come quickly to be seen as no more than a passing fad. That, however, is not all that there is to it. Whatever CSR is supposed to mean, we should be alert to what it is seen to imply.

The dangerous implications of CSR

The principal implication is that company directors and managers should direct their company to operate in the interests of parties other than shareholders beyond the requirements of law, whether or not to do so is in the interests of its shareholders. That implication arises from attaching to those other parties the misleading label of *stakeholders*: misleading in so far as it suggests that those other parties have as legitimate a claim on the company's ultimate wealth, after the company's legal obligations to them have been met, as shareholders.

What flows from that implication is that company directors and managers would face the insoluble dilemma of defining and weighing the interests of the various "stakeholders" and judging whose are to be preferred to others, and how they are to be variously weighed against the interests of shareholders. The touchstone that seems to be emerging to guide them through the dilemma is the notion of "society's" or "community" expectations. On examination, the notion seems worse than useless: *society's* is a cognate of the weasel word *social*, and *community* in this context is itself another weasel word, sucking out any real meaning from the word *expectations*.

The fact is that the application of those weasel words is a matter of politics, not business; and if CSR takes hold, we shall surely find the operations of companies increasingly directed not by the directors and managers as stewards for the capital-contributing shareholders in accordance with their general duties to the company, but by them towards the requirements of the State in its ever-changing assessment of community expectations. Company directors and managers will, inevitably, find themselves beholden in the conduct of their company's business not to the company and its shareholders, with all the consequent benefits to outside parties and to the community generally, but to the State and its politicians and bureaucrats. In the meantime, the countless citizens whose welfare depends on corporate profitability will find their welfare diminishing as the process proceeds.

The origin of CSR

As noted, prominent among the members of the WBCSD, and also no doubt other like bodies, are leading multi-national enterprises (MNE's). For all the great benefits they bring to the world at large, and to the advancement of less developed countries in particular, MNE's have for years laboured under attack from bodies purporting to represent the various interests of labour, women, children, consumers, the environment and other special interests, almost all of which bodies are imbued with an anti-capitalist mentality. CSR, and at least the pretence of implementing its nostrums is seen by its corporate proponents as a means of appeasing sectional activists; and by sectional activists as a means of quarrying more and more from the corporate sector. On both sides, the interests of a company's shareholders are seen as expendable in favour of outside sectional interests.

Corporate advocates of CSR, in seeking to appease sectional interest groups, seem not to be aware of, or to be content to ignore, three fairly obvious points. First, the single issue activist body is concerned solely about the supposed interest it purports to represent, and not about the interests of the community at large. Secondly, the wish-list of the single issue activist body can never be satisfied: satisfy one wish, and another bobs up. Thirdly, it has regrettably to be said that leaders in the corporate sector have on the whole been less than whole-hearted in reminding the pubic generally of how much it owes for its welfare to free market capitalism in general, and to the limited company in particular. Those of their number who seek to live by weasel words and buzz-words run the risk of dying by them.

At the other spectrum of the CSR coalition, those imbued with the anti-capitalist mentality, at a time when the failure of socialist regimes – particularly Marxist regimes – has become generally recognized, CSR can be seen as another means of knee-capping capitalism, in much the same way – albeit widely unperceived – as the German National- *Socialists* (the latter half of their label needs due emphasis) did, and under slogans pre-echoing those of CSR..

Conclusion

Were CSR to be understood as meaning no more than that company directors and managers should meet their duties under the law, and do what they reasonably can to ensure that their company does likewise, it can, and should, be seen as creating the unnecessary confusion that comes from, to borrow from a great English judge, well-meaning sloppiness of thought.

That, however, does not seem to be what proponents of CSR for the most part have in mind. The essential meaninglessness of the expression CSR has proved remarkably successful as a cloak under which to smuggle into the uncritical consciousness of businesspeople, lawyers – academic and practising – politicians, bureaucrats and the public generally, ideas that are potentially at least subversive of the institution of the limited company as it has evolved in the English-speaking world over the last 150 years. Once we grasp the essential meaninglessness of CSR, we are in a surer position to defend an institution to which, above all others, we owe the highest standard of living in all history. And let's also not forget Aesop's fable of the Goose and the Golden Egg.

Bibliography

A Google search on CSR reveals about 35,800,000 entries, so it cannot scarcely be said to be a subject on which literature is lacking. The writer would, however, comment to the Committee's attention:

The Company – A Short History of a Revolutionary Idea by John Micklethwaite and Adrian Wooldridge (The Modern Library, New York 2003). A concise, informative and entertaining history of limited company and its contribution to human progress by two editors of *The Economist*.

Misguided Virtue – False Notions of Corporate Social Responsibility by David Henderson (New Zealand Business Roundtable 2001). A concise but comprehensive critique of the nostrums of CSR and their potential to do real harm by undermining the market economy, thereby reducing community well-being world-wide. The monograph is useful also for bringing out the roles of MNE's and NGO's in the CSR movement.

The Art of Corporate Governance – A Return to First Principles by Samuel Gregg (The Centre for Independent Studies – 2001). This monograph by a young Australian moral philosopher, now attached to the Acton Institute for Religion and Liberty in USA, includes a critical analysis of stakeholder theory, the concept of triple bottom line and the notion of CSR.

The Economist. The issue dated 20 January 2005 contains a five article supplement on CSR. The supplement was reproduced in Australia in a subsequent issue of *Company Director*.

The writer

Tom Bostock is a Special Counsel to the Melbourne office of Gadens Lawyers, after completing 34 years as a partner of Mallesons Stephen Jaques. The views expressed in this submission are his own and should not be taken as representing the views of either of those two law firms or of any other body of which he is a member or with which he is otherwise associated.

19 Robinson Road,

Hawthorn, Vic. 3122.

Tel. (03) 9252 2592 (B/H) (03) 9818 2434 (A/H)

Fax (03) 9819 6885 Mobile 0408 673 975

International Institute for Self-governance
PO Box 266 Woollahra, Sydney, NSW, 1350
Ph: 02 9328 7466; Fax: 02 9327 1497: Mob: 0418 222 378
sturnbull@mba1963.hbs.edu

John Kluver,
Executive Director
Australian Government Corporations and Markets Advisory Committee
Level 16, 60 Margaret Street
SYDNEY, 2000
john.kluver@camac.gov.au

September 12, 2005

Dear John

Response to the reference on Directors' duties and Corporate Social Responsibility

Contents:

1. Summary
2. No changes in directors duties required but the scope of their reporting replaced
3. Why changes in corporate reporting are required
4. Summary responses to each of the seven parts of the terms of reference
5. Concluding remarks

1. Summary:

The recommendations of this submission illustrate how: (a) The interests of shareholders and directors can be protected and furthered while enhancing social and environmental responsibility and (b) The law, regulations, codes, and the cost of compliance can be reduced by introducing into corporate constitutions self-enforcing processes to report on and take into account triple bottom line issues.

This submission recommends that no changes are required in the duties of directors but there is a need for corporate constituents to be given appropriate voice to report on business activities and on the social and environmental impact of operations to shareholders, directors, investors and the general public. Reports by constituents would provide a basis for reducing the scope of information specified in statutory reports by directors while increasing the scope of information provided by the company.

It is not the duties of directors or the scope of their reporting that should be increased but the formal involvement and engagement of corporate constituents on whom all operating companies rely upon for their existence.

Three changes in corporate law are suggested:

(i) Non trivial[1] corporations[2] required to adopt constitutions that allow stakeholders to form advisory councils that represent the various constituencies of the corporation to inform the directors on business operations and any other matters of concern such as social and environmental issues.

(ii) A contingency power introduced to allow in exceptional circumstances when corrective and/or remedial action is not taken by directors for widespread social or environmental harms created by their company for the directors to be replaced by nominees of stakeholders.

(iii) A separate Auditor is appointed for non-trivial corporations by stakeholder councils to protect the entitlements of unsecured stakeholders by forming an opinion on the value of the enterprise on a liquidation basis.

The first change would provide a way to substantially reduce corporate law, other laws, regulations, and regulators by providing self-enforcing processes for corporate stakeholders to protect themselves. Besides reducing the cost of company regulation and compliance it could improve the protection of investors and stakeholders on a much more effective, quicker and flexible tailor made basis to company specific concerns rather than relying on one size fits all rules and regulations.

The possibility of the second change being activated would make directors and shareholders very sensitive to social and environmental impact of their company. It provides a compelling incentive for directors to promptly take corrective and/or medial action for any harms created by their company that attracted wide spread community concerns.

The third change might have saved the Australian government over a billion dollars in compensating employee and customer entitlements from the failure of Ansett and HIH as well as protecting their suppliers who were also unsecured creditors.

2. No change in director's duties is required but the scope of their reports replaced

No change in director's duties is required as they already have a duty to "the company as whole". This means directors have a duty to any stakeholder on whom any operating company must rely upon for its very existence and so its day to day operations.

As no operating company can exist without workers, customers and suppliers, including the infrastructure services provided by the host community, this means that directors already have a duty to the "strategic" stakeholders who constitute "the company as a whole". The term "strategic" is used because the very existence of an operating company is dependent upon individuals working in the firm or in supplier or customer entities or those that are individual suppliers or customers.

Investors are not considered strategic stakeholders as self-financing companies can exist without them (as shown with management buyouts) and investors can have a much shorter time horizon than individuals who are strategic stakeholders. Because only individuals are defined as strategic

[1] The definition of "non-trivial" corporations is considered in the concluding remarks.

[2] The term corporations is used to include those that are publicly traded, controlled by foreigners, governments or private individuals or are non profit incorporated bodies.

stakeholders their participation enriches democracy to support the political “license” for corporations to exist and operate.

Strategic stakeholders are citizens on whom any corporation must depend for its operations. They make up “the company as whole”. Taking into account the interest of strategic stakeholders is consistent with the statutory obligations[3] of directors to “exercise their powers and discharge their duties in good faith in the best interests of the corporation; and for a proper purpose.”

There is nothing in the law that places a duty on directors to maximize shareholder wealth although this is commonly stated or implied. Corporations may be used for non-profit and charitable purposes. It is quite legal for incorporated charities to distribute their wealth to non members. The need for directors to maximize shareholders wealth arises only in the context of the criteria used by shareholders to vote for directors or sell their shares. There thus appears no legal conflict for directors to consider the concerns of citizens who are strategic stakeholders. What strategic stakeholders require is a formal mechanism for them to be given a voice to inform directors of their concerns so these can be taken into account with such views that may be held by the shareholders who have the power to appoint, remunerate and dismiss directors.

In some corporations there are non strategic stakeholders who may be affected by the operations of the company as in the case of asbestos or tobacco victims. It is the strategic stakeholders with their long term interest to protect the reputation of the firm and its brands that can best represent non-strategic stakeholders. In practice, a number of strategic stakeholders could also be individuals affected by contact with asbestos or tobacco to create grass roots community pressure for the company to take corrective and/or remedial actions.

Some corporations might not have sufficient citizens as strategic stakeholders to influence directors to take corrective action. Only in such exceptional circumstances should governments become involved in regulating corporations. However, such regulation should be indirect based on only political action without the need for the intervention of any government bureaucracy or regulator.

To achieve this result the Corporations Law could be amended to allow the Minister to sign an order to retire directors and appoint nominees of stakeholders to allow the company to undertake the necessary corrective action. The threat of this provision being invoked would make directors and shareholders very sensitive to the requirements of their stakeholders without any need to change the duties of directors.

The question arises if this reserve power should be triggered only on political consideration of community concerns and/or on operational concerns of the cost and benefits to the community. A Ministerial discretion based on approaches from concerned stakeholders is one approach. The other would be concerned stakeholders seeking a court order based on a judgment of the cost and benefits of having new directors appointed. Either approach might be suitable or they could be combined. However, the Minister with such reserve powers should be the one most concerned with promoting corporations and investment rather than a Minister in charge of social or environmental matters.

[3] Refer to Corporations Law, Section 181 (1), http://scaletext.law.gov.au/html/pasteact/3/3448/0/PA002380.htm

To initiate corrective and/or remedial action operating companies need a “loyal opposition” to the hegemony of information and centralised power of the command and control hierarchies in typical modern corporations. For this reason, this submission argues that it not directors who should be required to provide additional information on the social and environmental impact of the company, but its shareholders and strategic stakeholders.

Indeed, the scope of information which directors are required to report is already excessive. Existing statutory duties of directors to report could and should be reduced by the establishment of formal arrangements for other corporate constituents, including shareholders to take over responsibility to monitor and report on matters that are of concern to them. In this way the amount of information reported would be greatly reduced as only information that was contentious would need to be raised and its distribution could be limited to those who had the will and power to act to make corrective action. Competitive commercial intelligence could in this way be kept confidential while still being used to initiate corrective action.

At present the law requires directors to report on many things just to cover the contingency that some may be contentious. Remuneration, related party transactions and corporate governance practices are examples. In most cases the information does not reveal contentious matters but this approach means that much more information is distributed than is required. This is costly and becomes distracting to recipients who are overloaded with unnecessary information as it indicated by shareholders who request companies not to send them their full annual reports. Reporting and compliance requirements also take up the time of directors and distract them from their fundamental role to direct and monitor management.

If representatives of shareholders and strategic stakeholders became responsible for reporting then all routine non contentious information could be kept private. This would substantially reduce the volume and cost of information that had to be reported publicly. It would result in exception reporting when a matter was contentious. The various advisory or watchdog boards would decide when disclosure was necessary.

To introduce regulation of corporations by its shareholders and strategic stakeholders corporate constitutions need to give appropriate voice to these constituencies. In this way corporate governance would be replaced by shareholder governance that was influenced by the concerns of its strategic stakeholders on who corporations are dependent for their existence.

How corporations are governed is defined by their constitutions. The reason why company law, regulation and government regulators have grown so large and complex is because corporate constitutions have not kept up with the requirements of investors and the community. Corporate constitutions should be designed to carry out the role of DNA that contains instructions for making all living things self-regulating in complex un-predictable environments on a competitive sustainable basis. Corporate law should follow this approach so as to minimize size, complexity and cost of company law and government regulators.

The science of governance explains the strategy found in nature for making living things self-governing and why self-regulation does not work in the way corporations are currently constituted. The approach recommended in this submission is based on the science of governance. However, the full potential of this approach is not the subject of this submission that is restricted to triple bottom line concerns. But some of the broader potential is indicated in the next Section.

3. Why changes in corporate reporting are required

A fundamental reason for a company to appoint directors is for them to monitor management and direct their activities. However, corporations typically have no systemic processes for Non-Executive Directors (NEDs) to carryout their fiduciary duties in this regards that is independent of the management that they monitor and direct. This is irresponsible. It defeats a fundamental reason for NEDs to be appointed to a board.

It is very much in the interest of shareholders and prospective investors that corporations establish systemic processes for NEDs to obtain the information independently of management to monitor and direct management and the company with due diligence and vigilance. For this reason, it is in the interest of shareholders to approve changes in corporate constitutions to provide the NEDs with processes for being informed independently of management on the Strengths, Weaknesses, Opportunities and Threats (SWOT) of both management and the business.

The most informed, expert and self-interested sources of information about the SWOT of management and the business resides with employees, customers, suppliers including services provided by the host communities. Each of these constituencies needs to have a process to inform management, NEDs and when appropriate shareholders and the wider community on the SWOT of management and the business. To achieve this objective and legitimate the role of NEDs, corporate constitutions need to provide a basis for each class of strategic stakeholder to nominate and elect its own advisory council. Stakeholder councils could provide “loyal opposition” to the views of management for NEDs to consider. In most contentious situations there can be more than one side to a story and NEDs need to become aware of these to responsibly select the most appropriate course of action.

Because no operating business can exist without its strategic stakeholders it also makes excellent sense for management to obtain feedback and feed forward information from the constituents of the firm. In this way they can obtain an early warning system on any problems or matters of contention and minimize and contain unpleasant surprises before issues are reported to the NEDs.

The involvement of employees, customers, suppliers and members of the host community in the governance of US corporations was recommended by Harvard Professor Michael Porter to make them more competitive in his 1992 report[4]. However, the involvement of such stakeholders should not be through the main board but through advisory boards. In this way the conflicts of interests inherent in any stakeholder involvement can be used to provide a conflicting viewpoint without also those being conflicted becoming involved in managing the conflicts. NEDs alone would manage any conflicts as part of their role to direct and monitor the business.

A legal requirement for non-trivial corporations to facilitate a process for constituents of a company to form advisory boards would provide a basis for reducing the scope of information that the law requires

[4] Porter, M.E. 1992, *Capital choices: Changing the way America invests in industry*, A research report presented to the Council on Competitiveness and co-sponsored by The Harvard Business School, Boston.

directors to report as the onus could be transferred to various councils or boards. It is the Stakeholder Councils, not the directors that should be required to present in corporate annual reports of non-trivial corporations the social and environmental impact of the business. It is the Stakeholder Councils that should appoint and control any social or environmental auditor along the lines outlined in my 1995 paper on "The Need for Stakeholder Councils in Social Audits" archived at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=55769 Details of the competitive advantages of introducing various stakeholder advisory boards and watchdog boards are presented in a number of my articles[5] archived in the Social Science Research Network library that are linked to my summary page at http://ssrn.com/author=26239

The need for a shareholder committee for publicly traded corporations is reinforced by the introduction of stakeholder councils so as to provide an authority independent of the directors but *with the interest of shareholders* to review the content of stakeholder reports to shareholders and so the public. The main role of a shareholder committee would be to manage director conflicts of interest such as those that arise from controlling the financial or any social or environmental auditors that may be appointed; the processes of how directors become accountable, remunerated, appointed and manage any other related party interest. However, another role would be to make substantial reductions in the scope of the information that statutory reports would need to be disclosed on these matters.

Auditors controlled by a shareholder committee avoid both the auditor and directors being subject to conflict of interests to allow auditors to carry out their legal role as explained in my article on "How US and UK Auditing Practices became muddled to Muddle Corporate Governance Principles"[6]. However, accounting and auditing standards do not provide a basis to protect employee entitlements and other unsecured creditors who can be customers as well as suppliers, so it is recommended that corporate law make provision for the Stakeholder Councils to have authority to appoint there own separate auditor to report on the value of the company on a liquidation value rather than a going concern value as presented to the shareholders. This would also protect shareholders as it would require their auditor to defend, and so make transparent their assumptions on which they formed their going concern value. This recommendation is also in the interest to the government who paid out in excess of a billion dollars to compensate lost entitlements of employees and customers from the failure of Ansett and HIH.

The need for corporations to build up a respected brand, maintain and build their reputations provides a basis for believing that NEDs would take notice of any adverse impacts that may be reported by stakeholder councils in regards to social and environmental issues. In exceptional cases where corrective action did not take place then governments could introduce exceptional remedies rather than introducing any additional burdens on directors and companies in regards to triple bottom line reporting and compliance.

It is for this reason that it is recommended that the law not be changed to increase director's duties or reporting requirement but instead that the law require non trivial corporations facilitate the

[5] For example refer to "Stakeholder Cooperation" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=26238 ; "Corporate Governance Reform: Improving competitiveness and self-regulation" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=41383 ; "Competitiveness and Self-regulation" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=45321 ; "The Competitive advantages of compound boards" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=277537

[6] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=608241

establishment of appropriate stakeholder councils and watchdog boards to take over some of the reporting obligations of directors and extend their scope to social and environmental issues.

4. Summary responses to each of the four points in the terms of reference

Set out below are summary responses to each of the four points raised in the letter of 23 March 2005 from the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, to the Advisory Committee.

Reference (1)

> *Should the Corporations Act be revised 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?*

Response to (1):

No changes are required in directors' duties but changes are required in regard to:

(a) Director reporting which could be significantly less detailed provided other corporate constituents became involved in reporting and became responsible for increasing the scope of statutory reports and;
(b) The tenure of directors who do not take corrective and/or remedial action in exceptional circumstances when the company has and/or is creating harms that concern the community as proposed in this submission.

Reference (2)

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

Response to (2)

Yes the Corporations Act should be revised to allow directors to be informed by specific classes of stakeholders and the broader community by corporate constitutions of non-trivial enterprises being amended to allow stakeholders to establish advisory councils. The advisory council established by employees should have the power to appoint an auditor not appointed by shareholders to report on the value of the company on a liquidation basis to indicate to what extent employee entitlements might be at risk.

Reference (3)

Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

Response to (3)

Yes Australian companies should be encourage to adopt socially and environmentally responsible business practices by their constitutions giving specific classes of stakeholders and the broader community the right to form advisory councils to give voice and represent social and environmental concerns.

Reference (4)

Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Response to (4)

Yes, non-trivial companies should require specific classes of stakeholders and the broader community to report on the environmental impact of corporations that are publicly traded or owned by foreigners, a State or Federal Government or privately.

5. Concluding remarks

The recommendation of this submission would introduce what I describe in my other writings as "Network Governance". Network governance also has application to public sector and non profit organizations. The strengths and weaknesses of this approach is outlined in my article "A framework for evaluating network governance of public assets" that is available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=786805

Network governance is explained in my public policy pocket book commissioned by the London based New Economics Foundation in 2002. The full text of the pocket book on "A New Way to Govern: Organisations and society after Enron" can be downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=319867

The main recommendation in this submission refers to "non-trivial corporations". How these might be defined could be matter of opinion and politics. The social and environmental impact of enterprises might depend upon the annual value of goods or services sold and the number of employees and suppliers. All this information is provided in the records of a company. An appropriate definition of a non-trivial enterprise might be one that had a total of 500 employees and suppliers of record with a turnover of at least $50 million.

However, the nature of the goods and services traded in smaller companies may be a critical factor in the social and environmental impact made so this is a factor that should also be considered in determining the application of any changes. Sample constitutions could be developed for companies and their shareholders to consider and these could be adopted on a voluntary basis for organizations that were not included in the definition of a non-trivial company.

The contents of this submission can be made public and I would be please to provide such follow up information that may be desired.

Yours faithfully

Shann Turnbull

Shann Turnbull
Principal, International Institute for Self-governance

Australian Shareholders' Association Ltd
ABN 40 000 625 669

28 September 2005

Mr John Kluver
Executive Director
Corporate and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

ASA submission: Corporate Responsibility

Thank you for the opportunity to contribute ASA comments on this topic.

ASA Position

The position of the ASA, in summary, is we expect that a board that operates in the best interests of the company will be mindful of its other stakeholders to ensure the continuation and evolution of the business. There appears to be no impediment to boards, management or companies reporting or focusing on their CSR efforts (as shown by Westpac, BHP Billiton and many others).

ASX Corporate Governance Council Principles

The existing Principles of Good Corporate Governance and Best Practices Practice Recommendations allow for coverage of CSR under Principle 7: Recognise and manage risk (includes non-financial risk), and Principle 10: Recognise the legitimate interests of stakeholders.

Smaller Companies

The ASX lists a large number of very small companies. We would highlight that a number of these smaller companies may be acting as good corporate citizens but perhaps not reporting their activities with sufficient fanfare. We suggest that the recent adoption of corporate governance principles and remuneration reporting, and then the adoption of international accounting standards in 2006 has been resource intensive, perhaps inhibiting the evolution of greater CSR reporting. However despite additional demands on smaller companies we have seen increased reporting of statistics such as lost time frequency rates.

We note that the Global Reporting Initiative is onerous for smaller companies. We believe that guidelines such as those provided by groups such Group of 100 and AICD would assist smaller companies in addressing CSR in a cost effective fashion.

ASA Policy

Our policy statement, *Shareholders expect,* includes the following statement:

2. Purpose of companies, and related management issues
2.2 Behaviour of company managers and directors
Shareholders expect the directors and executives of companies to act responsibly and ethically.

2.3 Financial performance is a primary goal

Subject to the foregoing level of compliance and behaviour, shareholders expect companies to use the resources entrusted to them to generate value for shareholders by maximising cash flows and profits over a time horizon appropriate to the primary activities of each company. This economic function should be their primary purpose.

2.4 Directors
Directors are elected by shareholders to oversee the management of companies in the interest of the company itself and its stakeholders. Shareholders, as the ultimate owners of the company and its primary stakeholders, expect directors to be accountable to them for the performance of this role…….

2.5 Corporate donations
ASA has stated in a separate key policy (*Political donations*) that it is not the role of companies to divert shareholders' funds to political purposes by the making of donations to political entities. It also states that when such donations have been made they should be disclosed and explained in the annual report. Donations, sponsorships and similar expenditures of a recognisably charitable nature are matters for decision by directors, and executives to whom such decisions are delegated by directors. Nevertheless, shareholders expect to be informed of unusual or significant expenditures of this nature, both as they occur and in the annual report. Where directors have links with institutions to which such payments are made the nature of the association and the payments should be disclosed as related-party transactions.

5. Communication with shareholders
5.3 General contents of annual reports
Shareholders expect annual reports to contain all matters of relevance to them in their position as ultimate owners (including political donations and charitable donations referred to above). This expectation includes matters of an environmental nature (especially material non-compliances with licences and regulations) and matters relevant to the social obligations of the company. However, shareholders expect the primary focus of the annual report to be the company's financial performance and financial position reflecting the financial function and purpose of the enterprise in which they have invested.

6. Meetings with shareholders
6.1 Conduct of meetings
Shareholders expect general meetings will be conducted in a way that permits reasonable expression of their views on matters to be decided and performance of the company. Shareholders expect the chairperson to control the meeting in an appropriate manner and not act dictatorially or defensively in protection of the board or other stakeholder groups, or in a confrontational way. Meetings of shareholders are not public meetings.

If you wish to discuss any thing further please contact me.

Yours sincerely

Stuart Wilson
Chief Executive Officer

27 February 2006

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Discussion Paper – Corporate Social Responsibility

The Group of 100 (G100), representing the Chief Financial Officers of large business enterprises in Australia, is pleased to respond to CAMAC's invitation to comment on the Discussion Paper titles 'Corporate Social Responsibility'.

1. *The issue of corporate social responsibility*

The G100 supports initiatives by its members and other corporations to develop reporting formats in respect of corporate social responsibility. Reporting of this nature is variously described as sustainability reporting on triple-bottom-line reporting. In order to facilitate the understanding of members the G100 produced 'Sustainability: A Guide to Triple Bottom Line Reporting' in 2004. This Guide can be downloaded from our website www.group100.com.au. In view of the current state of development and practice we do not consider that mandating a definition of corporate social responsibility is appropriate at this time and impose additional requirements beyond those already required under various legislation and regulation.

2. *Directors' duties – current position*

The G100 considers that directors are required to consider broader interests in addition to those of shareholders under their current obligations. Directors have a first duty to the interests of the company and would be derelict in their duty if they did not seek to ensure the long-term survival, financial performance and health of the company. It is only by doing so that a company will continue to grow and add value to the community in which it operates. In order to do so directors must ensure that the company continues to give appropriate recognition to the concerns and expectations of the community.

The G100 does not consider there is any need to change the present current legal framework under which a director is required to act in the best interests of the company. Under the present requirements directors may also respond to changes in community expectations about corporate behaviour in order to enhance the longevity of the company and to preserve its "licence to operate".

3. *Directors' duties – matters for consideration*

The G100 considers that mandating change is unnecessary in view of the current Corporations Law and other requirements. In many of these areas, as evidenced in the Business Council of Australia findings, the imperative is to remove regulatory duplication and contradictions rather than to impose another layer of requirements which may inhibit progressive behaviour on the part of companies and directors. The best encouragement for entities is to create an environment in which experimentation with reporting in this evolving area is able to flourish. In a competitive environment the priorities and reporting of leading companies will induce improved reporting by other companies in response to changes in community expectations. This is unlikely to occur under a mandatory regime.

This approach is consistent with the view of the co-chair of the World Business Council for Sustainable Development 'Beyond Reporting' project that "leading companies build sustainable businesses by embedding strong governance and corporate responsibility into their strategies and culture. By earning the trust of their employees, communities, trading partners and the capital markets, companies with a culture of corporate responsibility are able to generate value where others cannot".

4. *Corporate Reporting*

At present there are no formal reporting requirements other then requirements in respect of matters to be dealt with in the directors' report. The G100 considers that the current position is appropriate at this stage of development in respect of corporate sound responsibility reporting. Specifying requirements and imposing a "one size fits all" approach is likely to impede promising and innovative developments. In addition, in respect of listed companies, good reporting practice should lead to discussion of corporate performance on these matters in compliance with requirements for a review of operations and financial condition.

The G100 considers that at the present stage of development of reporting on these issues it would not be appropriate to champion/require/adopt a particular approach to reporting when flexibility and development of different approaches in applying competing methodologies is occurring. Current approaches which are popular may soon be superseded by other approaches as techniques and measurement methodologies evolve.

Reporting on non-financial and sustainability issues is in its infancy and improvements will occur as a result of experimentation by different types of companies. Approaches will vary depending on the nature of the company, its culture and activities, its relationships with the communities in which it operates. In these circumstances it would be unfortunate to mandate an approach on the basis of a current fashion.

For example, Westpac issued a sustainability report two years ago and in 2005, one of its competitors, the ANZ Banking Group, issued its first Corporate Responsibility Report. While both reports address corporate social responsibility issues, the fact that different formats and presentation approaches are used does not diminish their role in communicating to shareholders and other users.

These differences within an industry sector demonstrate that when considered across industry sectors, for example, mining which has different issues to manage a process with flexibility (rather than a one-size-fits-all) is the most appropriate and most meaningful approach to reporting rather than black letter law.

5. Encouraging responsible business practices.

The G100 agrees that responsible business practices should be encouraged. While there may be instances where directors have abrogated their responsibility the G100 believes that, in the vast majority of cases, directors take account of a broad group of stakeholders including shareholders, credit providers, employees, regulators, government and the community in discharging their obligations. This is also emphasised in Principles 3, 7 and 10 of the ASX Corporate Governance Council recommendations. An awareness of the expectations of the community will engender appropriate behaviour in the general course of events, as to do otherwise leads to erosion of a company's reputation and impairs its long-term survival.

Yours sincerely

THonan

Tom Honan
National President

GROUP OF 100

15 November 2005

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Director's Duties and Corporate Social Responsibility

The Group of 100 (G100) is pleased to respond to the request for comments on director's duties and corporate social responsibility.

Our responses to the questions are set out below:

1. *Should the Corporations Act be revised 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?*

   No. The G100 considers that mandating change is unnecessary in view of the current Corporations Law and other requirements. In many of these areas, as evidenced in the Business Council of Australia findings, the imperative is to remove regulatory duplication and contradictions rather than to impose another layer of requirements which may inhibit progressive behaviour on the part of companies and directors. The best encouragement for entities is to create an environment in which experimentation with reporting in this evolving area is able to flourish. In a competitive environment the priorities and reporting of leading companies will induce improved reporting by other companies in response to changes in community expectations. This is unlikely to occur under a mandatory regime.

   This approach is consistent with the view of Samuel A.Di Piazza, the co-chair of the World Business Council for Sustainable Development 'Beyond Reporting' project that "leading companies build sustainable businesses by embedding strong governance and corporate responsibility into their strategies and culture. By earning the trust of their employees, communities, trading partners and the capital markets, companies with a culture of corporate responsibility are able to generate value where others cannot".

2. *Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

   No. The G100 considers that directors are required to consider broader interests in addition to those of shareholders under their current obligations. Directors have a first duty to the interests of the company and would be derelict in their duty if they did not seek to ensure the long-term financial performance and health of the company. It is only by doing so that a company will continue to grow and add value to the community in which it operates. In order to do so directors must ensure that the company continues to give appropriate recognition to the concerns and expectations of the community. In the normal course of events this includes consideration of the impact of the company's activities on the communities in which it operates.

3. *Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?*

   Yes. While there may be instances where directors have abrogated their responsibility the G100 believes that, in the vast majority of cases, directors take account of a broad group of stakeholders including shareholders, credit providers, employees, regulators, government and the community in discharging their obligations. This is also emphasised in Principle 10 of the ASX Corporate Governance Council recommendations. An awareness of the expectations of the community will engender appropriate behaviour in the general course of events.

4. *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*

   No. At present there are no formal reporting requirements other then requirements in respect of matters to be dealt with in the directors' report. The G100 considers that the current position is appropriate at this stage of development in respect of corporate sound responsibility reporting. Specifying requirements and imposing a "one size fits all" approach is likely to impede promising and innovative developments. In addition, in respect of listed companies, good reporting practice should lead to discussion of corporate performance on these matters in compliance with requirements for a review of operations and financial condition.

Yours sincerely

THonan

Tom Honan
National President

LEON A DAVIS

LEVEL 28, 60 MARTIN PLACE
SYDNEY NSW 2000
TELEPHONE: (02) 9226 3050
FACSIMILE: (02) 9233 8203
EMAIL: leondavis@westpac.com.au

12 January 2006

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Director's Duties and Corporate Social Responsibility inquiry

Dear Mr Kluver

I am writing on behalf of the Business Roundtable on Sustainable Development (the Roundtable). The Roundtable is made up of chief executives and board members from some of Australia's leading corporations. A current membership list is at Attachment A. The Roundtable was established by the Australian Government to provide advice on sustainability issues.

At our last meeting we noted with interest the CAMAC inquiry into Director's Duties and Corporate Social Responsibility and agreed to make a submission and offer our assistance.

Roundtable companies Insurance Australia Group, Shell and Westpac have all made submissions to the Parliamentary Joint Committee Inquiry into Corporate Social Responsibility. In addition several members have had discussions with the chair of that Committee. The purpose of this letter is to draw the CAMAC Inquiry's attention to those submissions and clarify the position of the Roundtable as a group.

Summary of position

The Roundtable strongly favours voluntary rather than mandatory reporting of non-financial factors at this time. Non-financial reporting is quite a new discipline that has no Australian standard. However, the Global Reporting Initiative (GRI) provides a uniform standard for companies wishing to voluntarily report.

Regulation limits shareholder involvement and in our view it is important for shareholders to provide input to how their companies are run. Roundtable members are happy to discuss their positions further with the CAMAC inquiry team and outline their company's positions in more detail should this be required.

Issues

Roundtable members fully recognise the importance of businesses adopting sustainable and responsible corporate practices and incorporating non-financial factors into their day-to-day decisions. The long term viability of our businesses depends on effective management of both financial and non-financial elements in daily operations. Many Roundtable members have voluntarily begun to incorporate non-financial factors into their pubic reporting. This is an emerging arena: practices and protocols are evolving as each sector and company assesses priorities and concerns and begins to manage them effectively.

Moreover, in the Australian context where companies have diverse local and global concerns and impacts it is important to allow companies a high degree of flexibility in developing their approaches to sustainability. We believe that as awareness of non-financial risks increases, consumers, shareholders and markets will progressively demand higher standards of corporate responsibility.

Mandatory social and environmental reporting is an inappropriate response to these pressures and in practice would prove counterproductive. We believe a regulated, mandatory approach would create a culture of compliance rather than foster innovative, outcomes focused approaches.

The Global Reporting Initiative provides a recognisable and attainable standard for companies who choose to report against non-financial indicators. There is a growing use of this standard worldwide and many Roundtable members have already adopted the GRI as the framework for their reporting. This framework provides sufficient flexibility for companies to design reports which are both appropriate and comparable to other GRI reporters. Use of the GRI also ensures that Australia is meeting international best practice and that the Australian operations of international companies are comparable with operations in other countries.

If you require any additional information on the Business Roundtable on Sustainable Development, or would like to discuss these issues in further detail with our members, I suggest that in the first instance you contact Ms Jill Grant at the Department of Industry, Tourism and Resources on 02 6213 6105 or Mr Joshua Harris at the Department of the Environment and Heritage on 02 6274 1347. I of course, will be happy to clarify any of the above issues if you so desire.

Yours sincerely

Leon A Davis
Chair
Business Roundtable on Sustainable Development

Attachment A

Business Roundtable on Sustainable Development
Members December 2005

Name	Position	Company/Organisation
Mr Leon Davis AO *Roundtable Chair*	Chairman	Westpac Banking Corporation
Mr David Baffsky AO	Chairman	Accor Asia Pacific
Mr Glen Casey	Managing Director and CEO	Nylex Limited
Mr Peter Corish	President	National Farmers' Federation
Mr Hutch Ranck	Managing Director	Dupont, Australia and New Zealand
Mr Paul Perkins AM	Adjunct Professor	Centre for Resource & Environmental Studies
Mr Tim Warren	Chairman	Shell Australia Ltd
Ms Helen Lynch AM	Company Director	Westpac, OPSM
Mr Richard Goyder	Managing Director	Wesfarmers Limited
Dr John Keniry AM	Chairman	Ridley Corporation Ltd
Mr Charlie Lenegan	Managing Director	Rio Tinto Australia
Mr Michael Hawker	CEO	Insurance Australia Group Limited
Ms Alison Watkins	Executive Chairman	Mrs Crockett's Kitchen Ltd

SUBMISSION TO CAMAC

FROM

DAVID WISHART

1. INTRODUCTION

1.1. Who I am:

I am a senior lecturer in the School of Law and Legal Studies at La Trobe University. I have taught and published in the field of corporations law for 25 or so years.

1.2. The Question:

The questions put to the Corporations and Markets Advisory Committee ('CAMAC') are as follows:

1. Should the Corporations Act be revised 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?
2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?
3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?
4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

These questions were put to CAMAC as a result of the 2004 *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation*, D. F, Jackson Q. C., Commissioner, being an enquiry into certain transactions of the James Hardie group of companies.

As I understand the position, a report by Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, to the Ministerial Council on Corporations ('MINCO') has referred to that body the following questions:

- Whether the Corporations Act should be amended to make directors consider social responsibility as well as shareholder interests;
- Piercing the veil in the context of corporate groups, generally and specifically along the line of the employee entitlements provisions in Part 5.8A, although the toothless nature of those provisions is apparently acknowledged;
- The definition of 'creditor' and whether it comprehends personal injury claimants who develop their 'injuries' many years after the insolvency of the negligent company (the so called 'long tail' issue);
- Corporate restructures, especially the *ex parte* nature of proceedings;
- Australian procedures for allowing companies to move overseas; and

- The rules governing the cancellation of shares, especially the lack of redress in Part 2J since 1998.

Accordingly I take it that the questions put to CAMAC exclude the specific issues and law reform proposals raised by the Jackson report, apart from the first question put to MINCO.

I note that the main issue not covered by either set of questions is the role of advisors to corporations, raised by Jackson QC at pp 547-8 of his Report. It is very clear that the legal advisor to the James Hardie group, Allens, in particular and perhaps the legal profession in general have taken the view that service to the client outweighs other ethical limits to behaviour, yet many legal processes, like the approval of schemes of arrangement, require that this service be mediated by standards of behaviour, including disclosure, that operate against the interests of clients. The legal profession has been very quick to condemn auditors for a failure to uphold standards in the face of potential loss of business as evidenced by the HIH and One.Tel fiascos in Australia and Enron in the US, and legislation has been smartly forthcoming, but when faced with similar issues in its own backyard has only given a muted response.

Nevertheless the question faced by CAMAC is confined to the more general and theoretical one of responsibility within the corporation to persons other than shareholders. It is this I here address.

1.3. My Approach

Acknowledging the Committee's time and energy constraints, I have kept this submission short and to the point. (The point is, of course, as I have stated it in the section immediately above.) Indeed, in positive substance it consists of the Proposal set out in Section 3 below.

I have included Section 2 to clear the way for my proposal. It is about ideas, principles and concepts which should be discarded: an application of Ockham's razor, if you like, although I prefer the ancient Greek metaphor.

If the Committee wants clarification of any of this submission, please do not hesitate to ask. My email is d.wishart@latrobe.edu.au.

2. THE AUGEAN STABLE'S CONTENTS

2.1. Stakeholder Theory

Stakeholder theory imbues the first two questions posed to CAMAC. It pervades recent discussions of corporate governance and corporate social responsibility. Yet stakeholder theory was rejected as a viable normative postulate in the 1920s. It is at core simply the position taken by the American Realists just before that time: a rather simple structuralist sociology. It fails because it presumes what it is designed to solve: the identity of the stakeholders, the homogeneity and solidarity of their interests, and the processes, beyond begging its own question by nominating them as 'balancing', by which competing interests are to be resolved.

An example of the confusions that abound when stakeholder theory is applied to the issues of corporations law lies in the recent consultation the management of Telstra had with the Government. Was the government being consulted as a source of government funding or as a shareholder which might be asked for a capital contribution? And that is to simplify it, for it might have simply been a political move and the parties may not have been able to tease out exactly what is at stake. The definition of the Government as a stakeholder and what stake it was holding was as much up for grabs as the provision of funds.

Another example is that employees are often thought of as a clear stakeholder group and are distinguished from shareholder and creditor groups. Yet in some circumstances employees are shareholders, say if employee shares are issued, and subordinate one interest to the other. When the company undergoes voluntary administration, or indeed in any creditors' meeting, the employees are creditors through their entitlements. They then may or may not express interests as employees.

There is, however, a utility in stakeholder theory. It is simply that it provides a possible test, one amongst many, for what is proposed to be done. 'What is the effect on people with this particular interest?' is the question that it poses. In posing it, however, one must be careful to define exactly what the stake is and that that interest may be mixed with others for unanticipated results.

Given the above, legislation should not be drafted in terms of stakeholders. The term is meaningless and contingent, and the definitions of interests it produces are correspondingly tainted.

2.2. International competitiveness

Ever since the Porter project of the early 1980s, regulatory regimes have been seen to be an essential element within a discourse of international competitiveness. This has become allied to a stream of thinking known as 'Law Matters', which asserts that strong regulatory regimes on a neo-liberal contractarian model are successful in economic terms. Putting the two together results in a thrust towards a legal regime on the contractual/US/UK model, rather than, in the polar taxonomy adopted, the communitarian/ Code Civil model. The latter is supposed to allow for the influence of stakeholders, although it is more accurately described as an acknowledgement that enterprise is a relationship between capital, management and labour.

Essentially international competitiveness as a restraint on any politically feasible reform proposal in Australian Corporations Law is twaddle. 'Law Matters' conflates cause and effect: which comes first, economic development or attractiveness to the eyes of global business? The evidence, such as it is, is equivocal even within the literature. If anything, there is a trend to a blend of the two available models, although whether this is because either has good features is not discernable. It is more likely that it is simply an artefact of cultural regulatory globalism. Moreover, there is no one model even in the US where corporations law is a matter within the powers of the States. Further, US banking law is one of the most highly and arbitrarily regulated in the world and one beset by prudential crises, yet no-one would suggest that this means the US is incapable of financing its business sector. Perhaps there is a bare minimum of liberal governance in terms of enforcement of property rights, absence of corruption and so forth, but beyond that there are many far more persuasive factors than the particularities of a corporations law regime. For example, there is little suggestion that Australia's emphasis on fairness in its market governance structures is a severe inhibitor of investment. The Delaware preference as a matter of regulatory arbitrage producing efficient regulatory regimes and hence a model for adoption in the rest of the world again is based on the most equivocal of empirical studies. After all, News Ltd'd move now looks to have been based more on managerial self interest than shareholder welfare enhancement.

2.3. The US model

For obvious economic and cultural reasons literature out of the United States of America heavily influences Australian thinking. An example is in respect of the definition of the interests of the corporation: is it wealth or value maximisation? Another is in the necessity for and workings of a business judgment rule, now in sec 180(2) the *Corporations Act* 2001. Indeed, the frame of the debate represented by the questions posed to CAMAC presupposes a polarity between the various stakeholders arising out of the particular conceptualisation of corporation that obtains generally in US law.

US law corporations law derives from the state of English law in 1760. It is a development of incorporation by charter whereby the state creates a new body with regulations for its governance. Those regulations establish positions, or statuses, with roles and functions. The board makes business decisions and the stockholders elect the board. The doctrines of corporations law as expressed in most States of the US derive from this conceptualisation. It may be but, importantly, also may not be the nature of a company in Australia. Given that the law which is now in force in Australia went down a different path, one where company law was found in contract and equity, rather than contract and equity being applied to companies, the US conceptualisation of the corporation is not the general Australian idea of a company.

In Australia we still (should) think very differently. The way we (should) think is that the company represents the result of a constitutive act by the originating members. This constitutive act creates an institution in which procedures of decision-making are as provided in its constitution. Thus Australian corporations law focuses on procedures of decision-making rather than the functions of particular statuses. Australian corporations law allows for, even presumes, the essential humanity of the participants.

Mind you, Australia has received some of the alternative model in recent law reform. While it is not explicitly acknowledged, the New Zealand 1993 model is heavily influential. This is based on the Californian and New York codes, via Canadian Business Corporations Act. Thus the New Zealand Companies Act 1993 establishes the positions of shareholder and director, even the board of directors. While we here have adopted much, we still do not establish those statuses; rather we assume them to be sets of rights and obligations pre-existing the Corporations Act's interventions. Maine's aphorism is problematic in corporations law, for the movement between contract and status is perverse.

2.4. Proper Purpose

I note that the questions posed to CAMAC are carefully phrased to avoid implying that profit or wealth maximisation necessarily defines the interests to be taken pursued by directors. Of course, the questions do not deny such a connection but many might assume it. The connection is to be resisted.

The critical duty as defined in law is the duty to act for a proper purpose. It is calculated to align the interests of the directors with those of the company. But exactly what 'the company' means has always been problematic. This can be seen in the two aspects to the duty: the duty to act within the purpose for which a power has been given and the duty to act *bona fide* for the benefit of the company as a whole. The first is an attempt to find the interests of the company in the constitution of the company. The second looks to a calculation made by judges as to what lies outside the possible interests of the accumulated shareholders as an institution. In this there has been considerable debate about whether interests of persons other than members are involved. In view of the construction of company law as being about an association of members I am reluctant to move outside of member as stochastic residual cash flow claimant in the definition of the association to be taken regard of in the calculation to be made by a court. An example of the sort of matter which impels me to consider that this is the presumption on which corporations law is built is the difficulty of representing persons other than creditors in a Voluntary Administration.

Most relevantly, the 'interests of the company as a whole' is a test which is manifestly incapable of deciding matters between competing interests within the company. Both Latham CJ and Dixon J made that point as the core finding of *Peter's American Delicacy Co Ltd v Heath* (1939) 61 CLR 457. To broaden out the range of matters which fall inside the category by including the calculated interests of classes of persons not part of the decision-making structure presumed by law is simply to confer an extraordinary discretion on directors. As the next section discusses, this is not a sensible move.

That is not to say that the calculation made by judges as to what lies outside the possible interests of the accumulated shareholders as an institution involves the positive formulation of the interests of the accumulated shareholders, especially in the profit or wealth maximisation. There is nothing in Australian law which makes this connection as a general proposition.

2.5. Trusting directors

Stakeholder theory requires the interests of stakeholders to be balanced by decision-makers. In terms of corporations law, it asserts that directors should balance the interests of those whose interests are at stake, whether they be tort victims, employees, unsecured creditors, consumers or environmental activists. Within any limits of fairness or oppression that might be considered necessary, the directors are given a discretion. This is often said to be the situation that obtains in codetermination on the German model but that is, I think, to misunderstand the dynamics of the two-tier board.

The question then becomes whether directors are persons to whom such a discretion should be given. This might be answered by considering the position of the board of the James Hardie group when facing the choice of whether to proceed to separate out the asbestos liabilities. Even were we to believe the board when it is asserted that it felt constrained to decide in favour of separation because of its duty to promote the interests of shareholders, to allow them to consider the interests of the asbestos victims would not compel them to behave more humanely. It would simply allow them to do so. (Mind you, I do not for one minute think that the duty is as that board asserts.) Law reform should be undertaken on the 'bad man' hypothesis: what could the 'bad man' do in these circumstances? Large corporations have such power to wreak havoc in society; their structures should not permit 'bad men' to make socially unacceptable decisions without appropriate consequences.

This is not even to assert the tempting argument that directors are in general simply barely competent managers of dubious morality who get to where they are by accident of birth, personality of the right mix and a fortuitous set of circumstances in each individual case. Certainly we should not be fooled by the 'cult of the CEO' as Gideon Haigh puts it ('Bad Company: the Cult of the CEO' (2003) 10 *Quarterly Essay*), but for present purpose it simply is not necessary to argue the matter. The possibilities of societal damage inherent is the conferral of additional discretion on directors suffices.

2.6. Conclusion

The above asserts that stakeholder theory does not help much, the US model should not be followed and does not constrain us, and communitarian models are similarly inappropriate, yet that the decision-making structure inherent to our corporations law allows for moral and societal responsibility for decisions to disappear. This trick is similar to, and perhaps an inextricable part of the much vaunted risk-shifting that is made possible by the corporate form. It works like this: human beings bear responsibility in law and society for their actions. Some wear this responsibility more lightly than others, but it is presumed of us as humans in the structures set up to regulate our actions. On the other hand corporations are expected to behave for the benefit of members. This is justified within notions of societal responsibility by liberal notions of accumulated self-interest representing maximum societal happiness. The decision-making structures of companies are designed to accumulate self-interests and allow for the mobilisation of capital in the directions the process indicates. In these processes questions of moral and societal responsibility have no conventional place because the processes are designed to express self-interest. Thus the conventional restraint placed on individual human beings is removed from corporations as persons. Remembering that companies are in a position of greater power due to the state's facilitation of accumulated wealth under the strong central control of a few, those constraints are critical to the health of society.

Certainly corporations have been increasingly in recent years brought into the fold of societal responsibility (with the notable exception of corporate groups — a question left to MINCO). In some situations responsibility has devolved on corporate officers. But that is simply to band-aid the issue, because the problem lies in the design of the processes of decision-making of the corporation and not in the actions of some officers.

The question is, then, how to insert moral and societal restraints in companies' decision-making processes without conferring discretion on directors. The key, I think, is not to assume away the possibility that members of corporations can act as a moral community; indeed, it is to assume that the members are a moral community and would wish their actions as a community to be constrained in that way. This is indeed presumed by Australian corporations law — we simply have forgotten it. The proposal that follows seeks to draw on and strengthen these principles in ways that are not susceptible to being competed away.

3. A PROPOSAL

3.1. Overview

This proposal seeks to establish moral and legal responsibility for corporate action by drawing on a number of principles:

- The accumulated members of a company can form a moral community. A board of directors does not.
- In a constituted decision-making structure the expression of constraints on decisions is best effected through its constitution. This should be recognised and facilitated by corporations law.
- Braithwaite's 'corporate culture' is a useful means of recognising and implementing implicit restraints on behaviour.
- In competitive situations survival generally overrides morals, yet competition has its own ethical justification in the efficient allocation of resources. Nevertheless, moral constraints on competition can be economically theorised and justified, provided they are equally applied. In other words, races to the bottom must be avoided.
- Responsibilities to society are best expressed by society through societal institutions. Adherence is a choice for the individual based on some individual calculus and for which consequences must be borne. In the case of corporations that may be lesser profit, but this is offset by moral satisfaction. Lack of adherence must also be penalised in ways which at best mimic moral opprobrium and at least criminal liability.

3.2. MINCO's questions

For what it is worth in this venue, the questions for MINCO should, in my opinion be answered by:

- amending the *Corporations Act* 2001 ss 588V-X to allow pooling on the New Zealand model;
- strengthening of Part 5.8A by removing the intention requirement (pooling will remove the overly vicious effect of this);
- providing an equivalent of Part 5.8A for tort victims;
- providing an insurance system for the 'long tail' problem — I am reluctant to solve a general problem with bankrupt tortfeasors in respect only of corporate malfeasance;
- appropriate amendments in relation to corporate restructures and Part 2J; and
- an express duty of disclosure on professionals.

What follows presumes law reforms approximating that position.

3.3. First Step: Extend the application of the Criminal Code Act

As a support measure for what follows, the Criminal Code Act (Cth) should be extended to all crimes and torts. At present it only extends to Commonwealth crimes, and even then not to breaches of Chapter 7.

The purpose of the extension is to establish the 'corporate culture' concept as essential to the decision-making processes of every company.

There is a question of the constitutionality of this extension. Crime and tort in themselves are not within the powers of the Commonwealth. Yet neither is contract law and the *Corporations Act* 2001 ss 126-130 provides for the mechanisms by which a company makes contracts. Provision for tortious and criminal liability could simply be inserted into the Corporations Act after s 130.

3.4. Second step: Provide that a code of conduct for officers, meetings and boards is strong evidence of a culture of compliance if provided in the corporate constitution.

The code of conduct would provide for the bases of action within a company. While I expect that they would be subject to a deal of jurisprudence and later development, the matters they would cover is the expectation of compliance with laws and that the decisions of the company would meet the standards of a reasonably moral human being. The code would express shareholders' desires that the companies of which they are members not act in socially damaging ways.

I would expect that initial formulations of the code would be by panels and public discussion. The upshot would be inserted into the Corporations Act as a replaceable rule. To avoid a race to the bottom, an appropriate version of the code should be included in the ASX listing rules.

The incentive, even compulsion, for a company to include the code of conduct in its constitution is that it would provide good defences to legal action and moral opprobrium. If there is fault and the institution has acted as a moral community, the fault is the acting individual's. Failure to include a code would be taken to imply intention to act if not purposeful then at least recklessly for ill.

To take the Anvil Mining Ltd incident in Kilwa in the Democratic Republic of Congo, were my scheme to be implemented the focus of the enquiry (beyond as to what actually happened) would be whether Anvil Mining's code of practice allowed for abuses (if they happened). If not, then the code of practice allows for the visitation of liability on the officers who carried out the abuses and, if any crimes are involved, allows for their direct liability. If there is no code or it does not constrain decision makers, liability is correctly visited on the company as well as the officers, hopefully to the substantial detriment of the members. That they may not have been members at the time of the incident is of no concern because they are seeking to benefit from holding shares in a company unrestrained by the normal constraints of a social being.

How would this work in relation to corporate groups? In any subsidiary company without a code of conduct the employees are exposed to presumed liability. If there is control of the subsidiary, section 9's extension of the meaning of 'director' to shadow directors implies that liability for improper decisions lies on the holding company. And well drafted piercing provisions for criminal liability should complete the picture. Let us not forget that s 16 of the Partnership Act 1958 (Vic) applies in a similar fashion.

3.5. Third step: Strengthen section 140 in respect of the code of conduct.

To ensure compliance the code should be enforceable by members. They are the moral community and hence should be able to ensure that the conduct of their affairs is done in accordance with their agreed standards. Section 140 provides that the constitution of a company is enforceable as if it were a contract and is the logical place for enforcement of the code within the moral community.

The problem with s 140 is that it has been taken to not require compliance with every provision of the corporate constitution. Only those matters which directly and personally affect a member and then only as member are enforceable. There is considerable jurisprudence as to what 'personally and directly' means in this context. My proposed amendment could be particular, simply stating that the code of conduct is one of those things. On the other hand the opportunity could be taken to extend s 140 to allow for all provision provisions of a corporate constitution to be enforceable, the internal management rule to operating through s 1322. The s 1324 injunction could be similarly extended, just to make the issue clear.

3.6. Fourth step: Ensure 'proper' is defined *inter alia* by the code of conduct.

'Proper', for the purposes of '*bona fide* for the benefit of the company as a whole' has, as adverted to above, always involved the interests of members, often both present and future, as defined by the corporate constitution and objects. The code of conduct should become a substantial element in that calculus. There would then be no restraint upon directors or other officers from complying with the expected standards of conduct in Australian society. There would, on the contrary, be an implication that to fail to so act is improper and in breach of the Corporations Act and the general law. Failure to so act would also disable reliance on the business judgment rule in s 180(2).

To effect this step an appropriate amendment might have to be placed in s 182.

It is worth noting that proper purpose would remain enforceable by individual shareholders through the derivative action. Were a company to be made liable through a breach of the code, a wrong would be done to the company because the officer would have acted improperly. The derivative action should stand, strengthened if necessary, to ensure that the board does not become complacent about these matters.

3.7. Fifth step: Require reporting on social and environmental impacts at least in the code of conduct.

It is obvious that any system such as I propose relies on transparency. Reporting requirements are clearly implicated. But they are not as necessary as it might seem. The dynamic of my system is a moral corporate culture defined by a code of conduct. To place reporting requirements in the code reinforces the point that the members of the company are the moral community, and the board and officers of the company put it into effect. If there is no reporting of what is done, it is unlikely that compliance with the code can be established to protect officers. The judgment that has to be made is whether activities of corporations are sufficiently visible for societal processes to take effect or whether help has to given by mandated reporting. My inclination is to allow a scandal to dictate the answer.

In such reporting as takes place, provable spin is, of course, a matter of the culture of compliance and the assessment of the degree of compliance with the code of conduct.

4. QUESTIONS FOR CAMAC ANSWERED

In short, my answers to the questions put to CAMAC are:

1. No.
2. No.
3. Yes, by extending the criminal Code Act to all torts and offences; providing for a voluntary code of conduct in corporate constitutions, with special provision for listed companies; strengthening s 140 to allow for the code's enforcement, ensuring 'proper' conduct is defined by reference to the code, ensuring the derivative action and the business judgment rule take this sense of proper into account, and ensuring actions of corporations are visible.
4. Welcome but not necessary unless concealed wrong behaviour mandates it.

Very little of this would raise any controversy. It would be very hard for any person subject to a code of conduct to argue that they should be permitted to act outside the moral constraints on human beings.

David A. Wishart
13 September 2005

31 January, 2006

To: John Kluver, Executive Director
Corporations and Markets Advisory Committee

Re: Inquiry into Corporate Social Responsibility

Dear Executive Director,

This submission is in addition to my submission to the Parliamentary Inquiry into Corporate Responsibility. It largely summarises the views expressed in that submission, however it has been significantly motivated by recent arguments from various peoples and organisations indicating their position on the questions at hand. This submission specifically seeks to identify and clarify the inappropriate framing of these arguments.

Main arguments:

- The status quo position put forth by many of Australia's leading organisations conceptualises CSR from the altruistic approach;
- The appropriate framing of the Inquiry is not to include stakeholders in the sharing of the benefits of organisations, but to protect stakeholders against harms inflicted by organisations, thereby conceptualising CSR from the ethics-based approach;
- The Corporations Act should be rectified to prescribe that managers and directors should manage the organisation on behalf of shareholders, *but not at the expense of other stakeholders.*

Please feel free to contact me if I can be of further assistance in your deliberations.

Sincerely,

Ben Neville
Lecturer
Department of Management
University of Melbourne

Ph: 03 8344 1907
Email: banevi@unimelb.edu.au

This inquiry has been motivated by a growing perception within civil society that the relationship between business and society is imbalanced and unsustainable. Such imbalance is evidenced by the harm inflicted upon various stakeholders, including the natural environment, in the pursuit of profit. This public issue has come to a head in Australia with the inquiry into James Hardie's treatment of its employees suffering from mesothelioma and the subsequent attempt by James Hardie to escape the proper payment of reparations.

Therefore, the specific questions addressed by the Inquiry relate to the duties of directors in regard to their consideration of other stakeholders apart from shareholders.

The Committee will have received many submissions arguing for a status quo approach, as evidenced by arguments put forth in the media. For example, Ralph Evans, chief executive of the Australian Institute of Company directors, argued that any changes to "the way companies should act in this area is unnecessary and wrong"[1] (The Age, 8/12/05). Other organisations to put forth status quo positions include the Australian Securities and Investments Commission, BHP Billiton, Boral, Shell Australia, BP Australia, Coles Myer, Westpac and Insurance Australia Group[2]. These views carry considerable weight, including amongst them some of Australia's leading organisations on CSR.

Despite the gravitas of these views, I wish to put forth that they represent a misperception of the problem at hand. The conceptualisation of CSR in these arguments represents the 'altruistic approach', as it was presented in this inquiry's Discussion Paper. In this approach, the duties of directors are to manage organisations for the benefit of society as well as shareholders. This includes taking responsibility for solving social problems irrespective of the impact upon profit maximisation. As argued in the aforementioned submissions and clearly enunciated in the 1989 Senate report, the nature of the duty and who it is owed becomes an impossibly complex and contentious task, both for legislators and managers. Enough said.

However, these rebuttals to the proposal to mandate an altruistic approach to CSR misconstrue the issue at hand. The issue is to stop a James Hardie situation happening again. It is to eliminate harms, not mandate benefits. The aforementioned arguments respond to the question of whether government should legislate *for* responsibility. I put forth that the correct framing of the question, motivated by the James Hardie case, is whether government should legislate *against ir*responsibility.

From this perspective, CSR is conceptualised as an ethics-based approach, as presented in the Discussion Paper. In this approach, the social responsibility of directors is to manage organisations for the benefit of shareholders without causing harm to anyone else affected by the organisation's actions. This was exemplified in the Discussion Paper as "an in-principle decision of directors that the company will not engage in certain commercial activities, regardless of the opportunities or

[1] Evans, R., "A mistake for governments to change a law because of a specific case." The Age, 8/12/05.

[2] Gettler, L., "Enforced CSR would not work." The Age, 17/11/05.

potential profits, or will not deal with any organisation that fails to meet certain environmental or social standards" (p25).

If the James Hardie directors had followed the ethics-based approach they would never have allowed their employees to work with asbestos, foregoing the profits of producing asbestos building products; and they would never have attempted to underfund the compensation fund, despite the profits to be pocketed.

Currently, the legal infrastructure of our country does not adequately protect stakeholders from the harms inflicted by organisations. Due to the legal liability conundrum, no one can be punished for the actions of James Hardie. James Hardie corporation has received no punishment, as a profitable company is vital for compensation to be paid out. The share price initially dropped as the saga unfolded, but immediately recovered as soon as the findings of the court were released. The price is now approximately 20% higher than before the issue became public. Due to limited liability the directors of James Hardie have received no punishment. And yet it is they who signed off on the decisions that resulted in James Hardie profiting from products that have resulted in the deaths of users and the almost $2billion underfunding of the compensation fund. Only the former CEO and CFO are facing charges, not for initiating the decisions, but for lying to the court.

This is a seriously unsatisfactory situation. In bringing down his findings, Commissioner David Jackson stated, "The circumstances have raised in a pointed way the question whether existing laws concerning the operation of limited liability or the 'corporate veil' within corporate groups adequately reflect contemporary public expectations and standards"[3].

Currently, directors are "permitted" to consider the interests of other stakeholders apart from shareholders. Although this allows for an ethics approach, it also 'permits' directors to *not* consider the interests of other stakeholders. As such, it condones a James Hardie-like scenario where stakeholders are harmed and not properly compensated.

In summary, I argue that this 'permission' must be revoked and substituted with a mandate that directors *must* consider the effects of their actions upon stakeholders. This should not extend to including stakeholders in the sharing of the benefits of the organisation, as per the altruistic approach, but must protect them from harm inflicted by the organisation.

Therefore, I suggest the following change to the Corporations Act:

> *Managers and directors should manage the organisation on behalf of shareholders, but not at the expense of other stakeholders.*

[3] Hughes, K., "Hardie inquiry finds legal failings." The Age, 22/9/05.

Submission to the CAMAC Inquiry in relation to directors' duties and Corporate Social Responsibility

Therese Wilson, Lecturer, Socio-Legal Research Centre, Griffith Law School, Griffith University, Brisbane, Queensland.
(Telephone contact (07) 3735 3590; Email Therese.Wilson@griffith.edu.au)

a) Should the Corporations Act be revised 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, and to require directors to take those interests into account?

The Corporations Act should be revised to both permit and require directors to take into account the interests of a broader stakeholder group than just shareholders.

Organisational decision-makers should be required to consider the impact of their activities and decisions upon the broader community, taking into account the interests of stakeholders other than shareholders. Two key arguments which support this position are, firstly, that with power comes social responsibility; and secondly, that the 'unarticulated vision' underpinning corporate law's focus on shareholder protection, is an individualistic one, where all individuals act only in their own self-interest, separate and unconnected from one another. This is an unrealistic vision, which ignores crucial aspects of what it means to be human.

At its most extreme, there is a view that

> there is one and only one social responsibility of business- to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[1]

This view is reflected in 'shareholder theory', which involves an argument that the pursuit of profits for the benefit of shareholders is efficient in the sense of financially beneficial to society.

An alternative view is found in 'stakeholder theory' which requires companies to make decisions having regard to the effects of those decisions on those with a stake in the company such as suppliers, customers, employees, management and the local community.[2]

The economic efficiency argument in support of shareholder theory is not always maintainable, given that the pursuit of profits by one corporate entity may in some circumstances be of little or no benefit to society at large, due to externalities- where the costs of a company's activities are borne by society not the company. Conversely, where a corporate entity acts specifically to benefit social welfare, then financial benefits such as lesser reliance on government welfare, fewer bankruptcies and so forth, may follow.

[1] Milton Friedman, 'The social responsibility of business is to increase its profits' (1970) 32 *New York Times Magazine* 122

[2] Frederick Post, 'A response to the "social responsibility of corporate management: A classical critique"' (2003) 18(1) *Mid-American Journal of Business* 25

Another argument in favour of shareholder theory is that shareholders are in a unique position requiring special protections, given that they are property owners without management control over their property, but with special contractual rights as against corporate managers that should be upheld. This argument has been dismissed as factually inaccurate given that shareholders own a bundle of rights, not a share of corporate property. In that sense they might be likened more to beneficiaries than to property owners. Further, even if shareholders were to be regarded as property owners, the law often constrains the exercise of property rights and the uses to which property can be put where that exercise of rights adversely affects others. As Parkinson notes:-

> There is little to commend the view that shareholders should receive rewards that do not fully reflect the social cost of the activities from which they are derived. Similarly, investors should not be regarded as entitled to the proceeds of conduct that conflict with generally accepted non-consequentialist social or moral values.[3]

Finally, in terms of enforcing contractual rights, there is no negotiated contract between shareholders and corporate managers, except perhaps in the case of large institutional investors who do have a 'Shareholders' Agreement'. Shareholders' rights can be regarded as adequately protected by their right to elect or remove directors, amend the constitution, or in fact sell their shares if they are unhappy with corporate management. [4]

There seems to be a social expectation that corporations will behave in a socially responsible manner. Following the Tsunami disaster on Boxing Day 2004, a spokesperson for the Australian Shareholders' Association was criticised for expressing the view that:-

> firms should not generally give without expecting something in return…donations should only be made in situations that are likely to benefit the company through greater market exposure.[5]

The public criticism that followed caused the Australian Shareholders' Association to seek to clarify the comments made by saying that the Association was not opposed to such donations but that they should be fully disclosed to shareholders.[6] In effect, the public response in the wake of a human tragedy was indicative of a call to inject a degree of humanity into corporations; a call for corporations to exhibit the qualities that natural persons (hopefully) might exhibit in acting beyond self-interest, for example with empathy, care and concern for humanity, and generosity. Given the power and resources held by corporations, this idea is an attractive one. This is a call supported by 'political theory about the legitimacy of private power';[7] in which it is argued that:-

> the possession of social decision-making power by companies is legitimate…only if this state of affairs is in the public interest. Since the public interest is the foundation of the legitimacy of companies, it follows that society is entitled to ensure that corporate power is exercised in a way that is consistent with that interest.[8]

[3] John Parkinson, *Corporate Power and Responsibility* (1993), pp 334- 335

[4] See discussion on these points in Frederick Post, 'A response to the "social responsibility of corporate management: A classical critique"' (2003) 18(1) *Mid-American Journal of Business* 25, p. 27.

[5] Abc News Online, (2005) <http://www.abc.net.au/news/newsitems/200501/s1278005.htm> at 18 January 2005

[6] The Age, *Tsunami donation comments draw criticism* (2005) <http://theage.com.au/news/breaking-News/tsunami-donation-comments-draw=criticism/2005/01/07> at 18 January 2005

[7] John Parkinson, *Corporate Power and Responsibility* (1993), p. 23

[8] John Parkinson, *Corporate Power and Responsibility* (1993), p. 23

It has been argued that corporate regulation is currently based upon an

> unarticulated vision…of an individual independent and separate from others, motivated by self-interest, and possessing an entitlement to all that is in the world [9]

and that

> If instead of holding the illusion of non-unity or separateness of individuals we understand their interrelatedness, then rather than measuring institutions by what they produce or how they allow individuals to seek their own best self-interest, we would measure them by how they treat the most poor and vulnerable, and by how they enhance or threaten our life together as a community.[10]

This is not to say that self-interest and the corporate pursuit of profits must be abandoned, but rather, that there needs to be a greater balance- that corporations should be required to consider the impact of their activities upon the community at large. The current legal framework is very much slanted towards a protection of shareholders and their profits at the expense of a broader stakeholder group.

Company directors are under a duty to act in the best interests of the company under section 181 *Corporations Act* 2001 (Cth) and under general fiduciary principles. The company has been defined in this regard to mean 'the shareholders as a whole'[11] or, where a company is insolvent, the creditors. [12] In either case, it is the financial interests of those groups- as linked to the company's financial interests- that are regarded as relevant. This would seem to preclude an exercise of discretion by directors in favour of general social welfare, unless clear benefit to shareholders in terms of financial return can be demonstrated. Put another way, directors will potentially breach their duty to act in the best interests of shareholders if they exercise social responsibility in a manner that might impact on profits.

Australian case law confirms this position, but notes that where an exercise of social responsibility or philanthropy can benefit the company, for example by improving a company's reputation, then such acts can be justified.

> A company may decide to be generous with those with whom it deals. But- I put the matter in general terms- it may be generous to do more than it need do only if, essentially, it be for the benefit of or for the purposes of the company that it do such. It may be felt appropriate that the company acquire a reputation of being such.[13]

It is argued that corporate social responsibility is still open to corporations as a matter of directors' discretions, because of the courts' reluctance to interfere in the business judgments of directors.[14] This has been apparent in case law[15], and it is further strengthened by the enactment of the business judgment rule in section 180(2) *Corporations Act* 2001 (Cth). However a blatant disregard for the impact of a decision on financial return to shareholders would no doubt be viewed as a breach of directors' duties.

[9] Susan Stabile, 'Using Religion to Promote Corporate Responsibility' (2004) 39(4) *Wake Forest Law Review* 839 <http://ssrn.com/abstract=648162>, p. 839

[10] Susan Stabile, 'Using Religion to Promote Corporate Responsibility' (2004) 39(4) *Wake Forest Law Review* 839 <http://ssrn.com/abstract=648162>, p. 861

[11] *Greenhalgh v Arderne Cinemas* [1945] 2 All ER 719

[12] *Kinsela v Russell Kinsela Pty Ltd (In Liq)* (1986) 4 NSWLR 722

[13] *Woolworths v Kelly* (1990) 4 ACSR 431 at 446 per Mahoney JA

[14] John Parkinson, *Corporate Power and Responsibility* (1993), p. 279

[15] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; *Charterbridge Corp Ltd v Lloyds Bank* [1970] Ch 62.

The current legal framework and its emphasis on profit return also impacts upon corporate culture, in the sense that individuals working within the corporate structure are unlikely to bring to their corporate roles any personal sense of social responsibility that they may have. Drawing on empirical research, Christine Parker notes that

> Organizations often tend to destroy individuals' integrity by tearing apart their constituent 'selves'- their commitment to the business goals of the organization on the one hand, and, on the other, their personal ethical commitments (e.g. to family) and sense of social responsibilities (e.g. environmentalism).[16]

Despite the best intentions and moral fabric of individuals working within corporate structures, they will be legally and culturally constrained from behaving in a socially responsible manner to any greater extent than is necessary for strategic corporate purposes. The conflict between personal integrity and morality on the one hand, and duties as a corporate director on the other, was apparent in a statement by Meredith Hellicar, chair of the board of the James Hardie group of companies when responding to criticisms of the group's restructure which saw a separation of the group's ongoing asbestos liabilities from the balance sheet of group companies, leaving a shortfall in funds available to meet those liabilities. She said that:

> In considering the sometimes competing- or even conflicting- requirements of the law, community expectations and our own moral precepts, we did not respond with offers of funding support for any shortfall of the foundation. [17]

It seems clear that the current legal framework and the corporate culture that flows from it actively discourage corporate directors from acting in the interests of the broader community, except where there are clear strategic benefits, in terms of profit return to shareholders, in doing so. A revision of the Corporations Act to clarify directors' duties and the need for directors to consider the interests of a broader stakeholder group is desirable.

In terms of amendment to the *Corporations Act* itself, there should at least be an amendment to make it clear that corporate boards are entitled to have regard to matters of social responsibility in making decisions, and will not be in breach of their duty to act in the best interests of the company by taking such matters into account.

The notion that corporations owe social responsibilities should also be adopted by federal and state legislatures, to inform legislative reform on a range of issues. Governments, in their redistributive capacities, should use the concept of CSR to justify targeted regulatory measures against corporations, for example to require banks to contribute more significantly to overcoming the problem of financial exclusion in Australia.

Where, as a matter of social policy, it is determined that corporations operating within a particular industry should contribute to social welfare to an extent that requires more than the exercise of strategic CSR, government should regulate to permit and require such contribution. Any regulatory strategy should, however, be responsive to the conduct of the industry in question.

[16] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 32

[17] Mathew Charles, 'Hardie bid to Woo Investors', *Courier Mail* (Brisbane), 16 September 2004 2004, 37

It is submitted that relying on voluntary measures, such as a voluntary exercise of CSR, will not always be adequate to achieve policy goals as determined from time to time, because of the legal and cultural limitations upon the exercise of CSR as explored above. In order to be most effective, however, the regulatory response should be a *responsive* one, in the sense of being responsive to the conduct of the industry in question.

Taking the case of Australian banks for example, and their conduct in recent years in contributing to addressing the problem of financial exclusion in Australia, it might be argued that rather than direct 'command and control' regulation, a less interventionist, 'meta-regulatory' model of regulation would be more appropriate. The argument would be that

> regulation should respond to industry conduct, to how effectively industry is making private regulation work. The behaviour of an industry or the firms therein should channel the regulatory strategy to greater or lesser degrees of government intervention.[18]

One possibility is the model of 'enforced self-regulation' described as the public enforcement of privately written rules [19] or 'meta-regulation' which gives law a role in regulating self-regulation.[20] This might be possible on the basis that corporations such as Australian banks could be encouraged to undergo processes which , for example, the ANZ bank appears to have already undergone, whereby the corporation has become 'open' or 'permeable' to stakeholder concerns and issues. This has been achieved through a process of disclosure of information and extensive stakeholder consultation.[21]

One key difference between such a model and the *Community Reinvestment Act* model for regulating the social responsibilities of banks, which will be discussed below, is the ability of industry members to write their own regulatory rules. In the case of banks this might be done through expanding upon the current *Code of Banking Practice* 2003, which would then be approved by a state regulator and be enforceable by that regulator if those rules were not voluntarily complied with. Industry members would be required to self-evaluate their compliance and report upon that, and those reports would be subject to state audit and verification requirements.[22] The advantages of such a model are said to include an opportunity for corporations to internalise concepts of corporate social responsibility [23] and for corporate management to be committed to achieving social responsibility management[24] , as well as a likelihood that the rules as written will be well-informed and therefore effective and appropriate[25]. Such rules might include, for example, a requirement that banks contribute to addressing the problem of access to small loans by low-income

[18] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992), p. 4.

[19] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 133.

[20] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 246.

[21] Anz Bank, 'Our performance 2004: Making a sustainable contribution to society' (2004); Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 215.

[22] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 279.

[23] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 40.

[24] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 50.

[25] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 40.

consumers, through increased partnerships with community organisations, rather than as a stand-alone venture. This would be based upon banks' own experiences with pilot schemes such as the 'Step-Up Loan' conducted in partnership between National Australia Bank and Good Shepherd Youth and Family Service.[26]

b) Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Social responsibility reporting is being undertaken on a voluntary basis by some Australian companies.[27] Voluntary reporting has some merit in that it will require corporate management to give consideration to corporate social responsibility issues. However, policy makers should be mindful of the potential for voluntary, self-regulatory social responsibility reporting to amount to little more than marketing spin, in the absence of independent third party audit and verification.[28]

An example of legislation to require the exercise of CSR and reporting of that by corporations within a given industry is found in the *Community Reinvestment Act* 1975 (USA). Under that Act there is periodic evaluation of the performance of financial institutions in meeting the credit needs of the communities in which they operate, including the needs of low- and moderate-income consumers. That record is taken into account in considering a financial institution's application for deposit facilities, including in the case of proposed mergers and acquisitions.[29] The enactment and continuation of the *Community Reinvestment Act* demonstrates recognition by regulators in the United States that financial institutions must be required through legislation to serve the needs of communities, not just shareholders. It is suggested, however, that for reasons outlined above, where an industry has demonstrated a willingness to engage in CSR on a voluntary basis, the appropriate regulatory intervention might take a less interventionist form- being one of 'enforced self-regulation' or 'meta-regulation of self-regulation', in order to achieve industry commitment and effective, appropriate and well-informed rules. A blanket reporting requirement in the Corporations Act might not achieve that end.

[26] Corinne Proske, 'National Australia Bank Step Up Loan' (Paper presented at the Microcredit: More than just small change conference, Victoria, 10 June 2005)

[27] See for example Anz Bank, 'Our performance 2004: Making a sustainable contribution to society' (2004); Westpac Banking Corporation, 'Pressing On: 2004 Social Impact Report' (2004)

[28] See for example discussion in Sasha Courville, 'Social Accountability Audits: Challenging or defending Democratic Governance?' (2003) 25(3) *Law and Policy* 269

[29] Federal Financial Institutions Examination Council, *FFIEC web site* <http://www.ffiec.gov/hdma/history.htm> at 8 June 2004

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Westpac Banking Corporation, 'Pressing On: 2004 Social Impact Report' (2004).

Corporate Social Responsibility

The purpose of the Discussion Paper I think is to consider what steps should be taken to include corporate social responsibility in the business community. Such things as Directors responsibilities, reporting and changes in business practices all need to be considered. It's interesting to note in Australia there is a plethora of different legislative requirements at every level of Government covering corporate responsibilities.

My submission answering the questions at the end of each section of the Report is as detailed below.

1.5
How might corporate social responsibility usefully be described for working purposes ?.

Corporate Social responsibility is an expectation that business is to be conducted in an ethical and sustainable manner on behalf of its stakeholders and the wider community. Ethics and sustainability are linked since sustainability in the environment and its preservation is a moral responsibility for this generation to pass on to future generations.

Which approach or combination of approaches to responsible corporate behaviour is most appropriate.

The most appropriate approach to responsible corporate behaviour is to determine guiding descriptive principles, rather than to try and prescribe in detail a list of detailed obligations.

Prescriptive obligations create a compliance approach restricted to those obligations documented. Descriptive type principles on the other hand require imagination and are likely to lead to a more comprehensive review within the "Spirit of the Law" .

The same argument applies to International Accounting Standards to govern CSR which I think need to be descriptive and broadly based rather than in the form of detailed instructions, possibly leading to the creation of loopholes !.

Corporate Social Responsibility – A suggested example of a guiding principle:

Its is the responsibility of the Corporation, through its Directors and officers to ensure at all times that it conducts its business in an ethical and sustainable manner. The Corporation shall include in its Corporate Governance provisions those core values considered necessary to uphold this principle in the conduct of its business. The Annual Report is to include a narrative with key indicators demonstrating its adherence to this principle.

What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

The incentives for a company to conduct its business in a socially responsible manner are evidenced in enhanced brand recognition and improved shareholder returns. This is achieved as the stakeholders and customers recognise a company's values. Its reputation is thereby enhanced and ultimately the returns to shareholders.

The disincentives arise from competitors who obtain short term advantage by unethical work practices. The latter type of activity is evidenced in secretive conduct where communication is restricted to its direct shareholders.

Different or additional implications arise depending on the nature or size of the enterprise, for instance:

___ The sector or industry in which an organization operates.
___ whether a company has international operations

In practice
____ to what extent is corporate decision making driven by shareholder concerns

_ how do companies differentiate between various categories of stakeholders

__ in what ways do companies balance or prioritise competing stakeholders interest and

__ how do companies engage with stakeholders

A company operating as a multi national will have the added difficulty of operating in countries with different cultures and beliefs that impact on the core values adopted by the parent company. What is needed I think is a response which adopts the guiding principles but at the same time also recognise local boards management and integrity to implement theses principles under local conditions. Some multi national companies subscribe to a counselling service to provide on-line services anywhere in the world such as that provided by St James Ethics Centre. In this way, if conflicts arise, management has that facility of an independent partner to assist in the timely promotion of fair and ethical work practices.
Every company I think would also need to include an adherence to human rights as a core value to be specifically included in its corpoarate governance principles. Amnesty International is a natural partner and currently is aleady assisting corporates all over the world to effectively ensure this principle is maintained in all of its activities.

Traditionally the Annual General Meeting provided the opportunity for stakeholders such as their investors to meet and exchange information. Yet its significance in terms of attendance is declining. The meeting itself is costly to

organise and confusion often reigns over shareholder voting rights. Clearly it's time for a change in the nature of these meetings and the composition of Annual Reports.

Corporation decision making is driven by the returns it can achieve for its shareholders and pressure arises from analysts and Fund Mangers whose focus is largely on share price appreciation. Companies don't formally engage their various stakeholders other than through market research and by way of references to employees and community partners in their Annual Reports. Most negotiations with Stakeholders are due to the various legislative requirements.

In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company ?

Are there any changes that would enhance triple bottom line sustainability or like rep orting , including :

___increased level of clarity and comparability of these reports
___any suggested changes to external verification of those reports
__ whether any aspect of this reporting should be mandated and, if so, for what companies and in what respects (s)
__are there particular issues for small to medium enterprises

An avenue for improvement in communication with stakeholders would be a change in format and reporting by the Directors at Annual general Meetings where they reported on the broader issues of their responsibilities under CSR. At present reporting in Annual reports is characterised by a hap-hazard approach to ethical business practice and sustainability. The two are seen as different. I would contend they are one in the same. The question of ethics is generally covered by comment on corporate governance which defines the rules for the Board, its composition and responsibilities.

Vague notions are often included such as "To uphold high ethical standards throughout the organisation" without identifying how this is to be accomplished or what those standards represent in terms of expected behaviour. Hence I see the need for guiding principles to be included and frequently referred to in the narrative that makes up Annual Reports.

An avenue to effectively reflect CSR is in accounting standards and more particularly what is referred to as Triple Bottom Line Reporting which adds environment and social responsibility to existing traditional financial performance measures.
Eg : Key Performance Indicators could be included to show such things as reductions in green house emissions, electricity and water consumption per employee, or for multinationals to give examples of how adherence to universal human rights and labour standards cover employee benefits.

I think requirements to include guiding principles and reports on ethics / sustainability should be mandated for all substantive private companies (currently required to lodge accounts) and public groups.

2.00: whether, or in what circumstances, companies feel constrained by their understanding of the current law of director's duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions.
if so, is there any useful scope for clarifying the current law in this respect
Does the current law give directors sufficient flexibility to balance long terms and short term consideration in their decision making
Are any changes needed to the current law regarding the right of shareholders to express their view by resolution at general meetings on matters off environmental or social concern.

Directors take a legalistic view of their responsibilities, relying heavily on Executive Directors. Corporate Governance principles tends to be relied upon in terms of their commitment to stakeholders and the wider community.
I think the law does give sufficient power to Directors to balance long-term considerations in decision making.

I believe the provisions relating to shareholder voting are already confusing and require revision. Matters of social or environmental concerns are to be included.

Should the Corporations Act be revised 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?
Should the Corporations Act be revised to require directors to take into account of specific classes of stakeholders or the broader community when making corporate decisions?

As previously mentioned I think the Directors currently have sufficient power to make decisions in the best long term interests of the company, but it's advisable that a general provision be included in the corporation law outlining their responsibility to maintain CSR aspects. Such a broad provision should be descriptive and not prescriptive to specify responses to different classes of stakeholders.
Eg

It is the responsibility of the Corporation, through its Directors and officers to ensure at all times that it conducts its business in an ethical and sustainable manner. The Corporation shall include in its Corporate Governance provisions those core values considered necessary to uphold this principle in the conduct of its business. The Annual Report is to include a narrative with key indicators demonstrating its adherence to this principle.

4.00 Should the Corporations Act Require certain types of companies to report on the social and environmental impact of their activities

I think all substantive private and all public companies should have an obligation to report on the social and environmental impact of their activities.

As mentioned earlier I think it is a mistake to view sustainability as a separate aspect to that of ethics, since sustainability is a moral question to sustain that which we have for future generations.

Hence it is preferable to include this requirement as a central principle of corporate governance requiring boards to ensure they have sufficient information and expert reports to discharge their CSR responsibilities.

5.00 Should Australian Companies be encouraged to adopt socially and environmentally responsible business practices and if so how?

Conclusion.

Australian companies should be actively encouraged to adopt socially environmental responsible business practices. In fact this should always have been the case. It is an indictment of our civilised state to think otherwise. The alternative is to give no consideration to sustainability and disregard the rights of future generations.

My preference is for descriptive provisions to operate by way of guiding principles enacted in law and within corporate governance structures.

Otherwise I think we are in danger of thinking of ethics and environmental sustainability as something only very highly trained people are capable of thinking about. CSR needs to stay in the mainstream of shareholder and stakeholder concerns, acknowledged at every level in the community.

As mentioned in the discussion paper, over 80% of investors want to see more reporting of CSR by companies. Educational bodies need to encourage education and ethically based subjects in their courses

Descriptive provisions create a clear responsibility. Imagination and morality have always been required for civilisations to deliver results for its populace along with new knowledge and understanding.

Lindsay Byrnes CPA ACIS

Brotherhood
of St Laurence
Working for an Australia free of poverty

ABN 24 603 467 024

Brotherhood of St Laurence
67 Brunswick Street
Fitzroy 3065 Victoria Australia
Telephone: 03 9483 1183
Facsimile: 03 9417 2691
DX 282 Melbourne

13 February 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Parliament House
Canberra ACT 2600

Dear Mr Kluver,

Thank you for the opportunity to participate into the Corporations and Markets Advisory Committee (CAMAC) inquiry into corporate social responsibility. This inquiry has the capacity to contribute to the development of a legal framework that encourages directors to be proactive and innovative, and to contribute to sustainable business practices that exceed the existing stated legislative, legal and fiduciary requirements, and contribute to wealth creation benefits in the broadest sense. In particular, it provides scope for discussion about how companies can adopt socially and environmentally responsible business practices.

The inquiry is timely in that it coincides with the inquiry of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) into corporate responsibility and triple bottom line reporting. The Brotherhood of St Laurence has made a submission to that inquiry and has been invited to appear as a witness later this month. Given the similarities in the terms of reference of the two inquiries, particularly with regard to revisions to the Corporations Act and directors' duties and the role of stakeholders and the broader community, I draw your attention to the earlier submission attached.

The submission draws on the extensive experience of the Brotherhood of St Laurence Ethical Business Unit in the area of corporate social responsibility, supply chain management and labour rights. This work has resulted in a close working relationship between the Brotherhood of St Laurence and the OECD with regard to the OECD Guidelines for Multinational Enterprises.

Also attached is supplementary material which relates to questions 3 and 4 of this inquiry, concerning social and environmental responsibilities.

I look forward to the outcome of this important inquiry and would be delighted to assist further if required. Please do not hesitate to contact the Brotherhood of St Laurence concerning our submission.

Yours sincerely

Tony Nicholson
Executive Director

Brotherhood of St Laurence
Working for an Australia free of poverty

Corporate social responsibility

Supplementary material to the Australian Government Corporations and Markets Advisory Committee

Brotherhood of St Laurence
February 2006

Introduction

The Brotherhood of St Laurence (BSL) is a Melbourne-based community organisation that has been working to reduce poverty in Australia since the 1930s. Our vision is 'an Australia free of poverty'. Our work includes direct service provision to people in need, the development of social enterprises to address inequality, research to better understand the causes and effects of poverty in Australia, and the development of policy solutions at both national and local levels.

The BSL is actively involved in ethical business and corporate social responsibility (CSR) in its own commercial enterprises, with an emphasis on responsible supply chain management in China and Australia. This experience has been enhanced through ongoing research into CSR and active participation in several corporate stakeholder engagement processes, involving the ANZ Bank, AXA, Westpac and the National Australia Bank.

The BSL works closely with the Australian National Contact Point (Foreign Investment and Trade Policy Division, Treasury) to promote the OECD Guidelines for Multinational Enterprises and has presented at the OECD Roundtable on Corporate Social Responsibility in Paris (June 2002). The BSL's Ethical Business Manager, Serena Lillywhite, is the Australian representative on the OECD WATCH Consultative Committee and in 2004 prepared a submission to the OECD Steering Committee as part of their review of the OECD Principles of Corporate Governance.

This submission to the Australian Government Corporations and Markets Advisory Committee should be read in conjunction with the BSL submission to the parallel inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into corporate responsibility and triple bottom line reporting. This document raises additional matters that relate specifically to questions 3 and 4 of the CAMAC terms of reference. The two documents jointly form the BSL submission to this inquiry.

Q3 Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

Australian companies have a responsibility to adopt socially and environmentally responsible business practices, and must be encouraged to implement these practices. This will:

- contribute to the positive impact that Australian companies can make to sustainable global trade and investment, particularly in developing countries, economies in transition, and countries in conflict or with weak governance
- ensure that not only *economic* development is planned, but also development that contributes to wealth creation benefits in the broadest sense, including sustainability, social inclusion, equality and human rights
- encourage greater implementation of international treaties, standards and mechanisms that form part of the global corporate governance framework (e.g. OECD Guidelines on Multinational Enterprises, ILO Declaration on Fundamental Rights at Work, UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights, Rio Declaration on Environment and Development, and the Monterrey Declaration)
- encourage the development of instruments, mechanisms and business practices that provide adequate protection for the rights, interests and development needs of host governments, their citizens and their natural environment
- promote good governance and ethical business practices through enhanced transparency and accountability
- improve overall business practices and competitiveness.

Encouraging Australian companies to embrace ethical business practices, not only in Australia, but throughout their global production networks has proved difficult to date and has achieved only partial success. The current practice of voluntary corporate social responsibility (codes of conduct etc) has not provided adequate protection for workers, communities and the environment.

Voluntary mechanisms are useful in harnessing a company's initial commitment to CSR, but more needs to be done to ensure that commitments are implemented and business practices reflect not only the economic, but also the social and environmental, implications of business decisions. This could be supported by:

- promoting the OECD Guidelines for Multinational Enterprises to business, and timely and transparent handling of complaints brought before the National Contact Point (based in Treasury)
- targeting export finance and insurance schemes at those companies that can demonstrate ethical business practices that adhere to social, developmental, environmental, cultural and human rights standards
- broadening trade development and investment advice offered by Australia's trade commissioners to potential investors to include information about corporate social responsibility and compliance with local laws and international standards
- ensuring industry awards, corporate ratings and other mechanisms that identify companies as examples of 'best practice' give rigorous attention to evidence of a working CSR framework. This will foster an Australian corporate culture that values and rewards ethical business practices.
- encouraging industry associations to develop company membership criteria that includes ethical business practices and a functioning CSR framework
- including in free trade agreements and other bilateral investment mechanisms social and environmental clauses and recognition of human rights
- making reference to the OECD Guidelines for Multinational Enterprises in all relevant government policy documents

Q4 Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

The following comments relate to companies involved in international activity. It recommends reporting on activities both within Australia and abroad.

The Corporations Act must require all companies engaged in cross-border activity (listed and unlisted disclosing entities, multinational enterprises and small and medium-sized businesses) to file not only a financial and directors' report, but also a report that documents the social and environmental impact of the business activity and their decisions. These reports must include:

- accountability in accordance with best practice reporting systems, such as the Global Reporting Initiative
- disclosure of business systems and operations that provide evidence of compliance with the OECD Guidelines for Multinational Enterprises
- disclosure of all export finance, insurance and other credit subsidies and guarantees (to ensure these are being directed to enterprises that practice and promote ethical business)
- disclosure of the business operating systems, including all supply chains, subcontractors, licensing arrangements, agents and production networks (companies such as Nike and Levi's now do this)

- disclosure of all government-business contracts and business revenues
- disclosure of internal management systems and practices which evaluate and monitor the social (developmental, social and human rights) and environmental impact of their activities
- disclosure of external processes (such as community advisory committee's, stakeholder engagement panels, auditors and certification schemes) which evaluate and monitor the social (developmental, social and human rights) and environmental impact of their activities
- disclosure of dispute settlement mechanisms (including processes for staff and employees throughout supply chains to raise concerns) that uphold local laws and protect essential social and environmental rights from expropriation rules
- reporting business systems and evidence of a corporate culture that upholds human rights and protects public health, safety and the environment
- reporting how the business operation contributes to sustainable development and investment and guards against financial instability

Conclusion

This supplementary material and the BSL's submission to the parallel inquiry being conducted by the Parliamentary Joint Committee on Corporations and Financial Services draw attention to the international dimensions of CSR and the responsibilities companies have to meet social and environmental best practice, and offer some tangible steps towards implementation and reporting.

In particular, it suggests that any changes to the Corporations Act recognise the global dimensions of business, and the fact that most companies are operating in a range of jurisdictions. This adds to the complexity of CSR and warrants a range of responses considering business impact on all stakeholders—including local communities and supply chains. It suggests this is best achieved by developing and implementing systematic business processes and a corporate culture that values ethical practices. It calls for greater transparency and accountability, and confirms that organisational decision makers can play a key role in ensuring this. These responsibilities should be acknowledged in the Corporations Act and all companies involved in cross-border trade must broaden their reporting to encompass the social and environmental impact of their business activity.

It is recommended that the CAMAC give consideration to the OECD WATCH report *Five years on: A review of the OECD Guidelines and National Contact Points* available on the OECD WATCH website <www.oecdwatch.org>.

For further information regarding this submission, please contact
Serena Lillywhite
Manager, Ethical Business

Brotherhood of St Laurence
67 Brunswick Street
Fitzroy Vic 3065

Ph: (03) 9483 1379
E-mail: slillywhite@bsl.org.au

Brotherhood
of St Laurence
Working for an Australia free of poverty

Corporate responsibility and triple bottom line reporting

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Brotherhood of St Laurence
September 2005

Introduction

The Brotherhood of St Laurence (BSL) is a Melbourne-based community organisation that has been working to reduce poverty in Australia since the 1930s. Our vision is 'an Australia free of poverty'. Our work includes direct service provision to people in need, the development of social enterprises to address inequality, research to better understand the causes and effects of poverty in Australia, and the development of policy solutions at both national and local levels.

The BSL is actively involved in ethical business and corporate social responsibility (CSR) in its own commercial enterprises (including Mod-Style, an optical frames importing business), with an emphasis on responsible supply chain management in China and Australia. This experience has been enhanced through ongoing research into CSR (see Holm & Lillywhite 2002; Lillywhite2003; Lillywhite 2005), and active participation in several corporate stakeholder engagement processes, including Westpac and the National Australia Bank.

The BSL works closely with the Australian National Contact Point (Foreign Investment and Trade Policy Division, Treasury) to promote the OECD Guidelines for Multinational Enterprises and has presented at the OECD Roundtable on Corporate Social Responsibility in Paris (June 2002) and the OECD Global Forum on International Investment in Shanghai (December 2002). Additional work has included presentations at the OECD Watch International Multi-Stakeholder Roundtable in Brussels (March 2005), and the OECD Investment Committee consultations (April 2005). The BSL's Ethical Business Manager, Serena Lillywhite, is the Australian representative on the OECD WATCH Consultative Committee and in 2004 prepared a submission to the OECD Steering Committee as part of the review of the OECD Principles of Corporate Governance.

A) Current regard of stakeholder interests by organisational decision makers – what happening now?

Global context of CSR

This inquiry into corporate responsibility and triple bottom line reporting (TBL) provides an opportunity to ensure that consideration is given to revising the Corporations Act and the current legal framework governing directors' duties to ensure the broadest interpretation of corporate social responsibility (CSR) and lasting application of the Act. In particular, it identifies two key areas for revision:

- greater emphasis on compliance with local laws (including labour laws) in countries of operation and with international standards
- development of a corporate culture and processes that value and support ethical business practices.

Current international thinking places the corporate governance framework within the broader CSR framework; however, the existing Corporations Act has a narrower interpretation focused on the responsibilities and obligations of the enterprise and board of directors.

The Brotherhood of St Laurence's research and active participation in corporate/community stakeholder processes has revealed that many enterprises, particularly multinational enterprises, are increasing developing CSR practices and reports in response to global trends. This suggests that in practice, some enterprises and boards are already operating beyond the narrow requirements of the Corporations Act.

The degree to which enterprises observe fundamental principles of CSR and good governance is now an important factor in investment decisions and sustainable development objectives. In addition, CSR and TBL reporting are increasingly being included in risk management strategies and activities, and this has necessitated consideration of broader issues such as staff training and the impact of operations on local communities. Further, the more innovative enterprise decision makers are now using a strong CSR platform to develop a competitive advantage, and recruit and retain good staff.

The term corporate citizenship is being used by some enterprises and the media in response to recent adverse corporate events (involving HIH, Enron, James Hardie, etc.) to demonstrate the business leaders' growing awareness that they have responsibilities that go beyond what is stated in the Corporation Act. The challenge for key personnel, however, is to operationalise their commitments and develop a corporate culture that values ethical business practices. As enterprises consider the social and environmental impacts of their operations, as well as the economic, it appears that environmental concerns are proving to be an easier starting point than social concerns. Measuring waste, undertaking environmental impact assessments and purchasing environmentally friendly equipment are easier to implement than addressing some of the social impacts such as the use of 'sweated labour' and human rights abuses amongst supply chains.

The international community, particularly through multilateral bodies such as the ILO and the UNDP, is also actively involved in promoting CSR. Both private and non-governmental authorities are playing an increasing role in the social regulation of business. International organisations, some commercially focused, are funding projects that enhance commercial relations, while others support civil society organisations that develop and deliver occupational and other health programs, promote empowerment and contribute to improved governance and accountability. Not surprisingly, several consultancy groups have emerged with a commitment to enhancing working conditions and understanding responsible supply chain management. A role is also being played by international lobby groups and forums that support workers' rights: these include China Labour Watch, Business for Social Responsibility, Marie Stopes International and (until its recent disbanding) Global Alliance for Workers and Communities.

Listed below are some of the current responses to CSR and issues for consideration in this inquiry. Further detail and examples can be found in the references.

Codes of conduct

Corporate social responsibility processes are most commonly implemented through corporate codes of conduct (developed, for example, by Nike, Disney, Reebok, Timberland); through factory certification instruments, such as SA 8000; and, to a lesser extent, through multi-stakeholder initiatives such as the Ethical Trading Initiative [UK] (companies such as Pentland and Sainsbury's have adopted ETI processes), the Fair Labor Association [USA] and the Fair Wear Foundation (Netherlands). There are also industry-specific standards (for example in the textile and apparel industry) and multilateral mechanisms such as the OECD Guidelines for Multinational Enterprises, the UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights, the Global Reporting Initiative, and the UN Global Compact.

Corporate codes and certification standards are important, alongside national laws and international standards, in fostering core labour standards (particularly where national laws are inadequate or poorly regulated) and in identifying some problems and compliance issues. However, codes too often represent a shallow attempt to understand the real issues in transnational supply chain management or to address long-term sustainable efforts to promote fair and decent working conditions. Codes of conduct do not necessarily reflect or ensure acceptable factory and labour conditions. Codes are often developed at a distance, without involvement and commitment from both workers and managers. They are frequently poorly promoted and understood within factories, and workers are usually not given an opportunity to comment freely and without reprisal on their operation in the workplace. In addition, many codes are insensitive to local laws and customs; and they may ignore country-specific labour relations or different understandings about the role of trade unions, for example by claiming that the principle of freedom of association is honoured. A recent report by Students and Scholars Against Corporate Misbehaviour (SACOM) documents the inadequacy of codes and audits in factories that produce books for Disney in China (SACOM 2005).

In isolation, codes cannot be relied on to protect workers' rights, nor should they be seen as alternative to national labour laws or a substitute for government ratification of international labour standards. Codes of conduct can, however, be a useful first step in harnessing an enterprise's commitment to CSR, particularly when accompanied by a meaningful and independent process of monitoring and compliance.

Monitoring and compliance

An important aspect of CSR concerns the monitoring, compliance and enforcement of Codes. This is complex and problematic. Inspections tend to be ad hoc and not necessarily undertaken by personnel skilled enough to identify falsified information (LARIC 2000). A further concern is the level of independence of the auditors. For example, it is not uncommon for multinational enterprises to engage large accounting firms to undertake factory audits in China to monitor compliance with company codes. These are often the very same firms that provide other accountancy and financial services to the enterprise and there is concern amongst some NGOs about potential conflict of interest and lack of independence.

Risk management (and the potential for 'brand damage' and consumer criticism) is currently the real driver of CSR and compliance mechanisms, particularly when the enterprise is operating in developing countries with poor labour practices (such as China) or conflict zones (such as the Democratic Republic of Congo). However, the influence of stakeholders on enterprises' corporate governance framework and day-to-day operations is increasing. These stakeholders include trade unions, non-government organisations, local communities and consumers. For example, since 2000, trade unions and NGOs have raised 100 cases against enterprises that are in breach of the OECD Guidelines for Multinational Enterprises (Feeney, in press).

Responsible supply chain management

Responsible supply chain management is a critical aspect of CSR. Within Australia's textile industry, mechanisms such as the Homeworkers Code of Practice and the Victorian Outworker (Improved) Protection Bill, and prosecution of some local garment manufacturers by the Textile Clothing and Footwear Union, have resulted in some improvement in supply chain transparency and accountability and improved conditions for home-based outworkers. This trend is set to continue with the planned introduction of mandatory legislation in Victoria.

Relatively few organisations, however, recognise that they share responsibility for labour standards and human rights abuses that occur among their suppliers of goods and services, particularly offshore.

When enterprises engage in cross-border trade, supply chain responsibility becomes more complex. Indeed, decisions to procure goods and services from countries such as China, India, Vietnam and Indonesia are often made to appropriate the benefits of cheap labour. The increased use of production networks that encompass trading houses, wholesalers and licensing agents tends to mask the factories and the conditions under which goods are made.

Nike's recent move to make available information on more than 700 suppliers is an indication that the larger enterprises are beginning to take greater responsibility for their supply chain. This assists in 'debunking' some concerns that supply chain transparency will compromise commercial confidentiality.

Training and capacity building

The more innovative enterprise decision makers are beginning to recognise the limitations of codes of conduct and of monitoring and compliance mechanisms. These organisations are undertaking small but important training programs, to build capacity offshore and develop relationships with suppliers and local stakeholders to promote CSR, encourage fair and decent working conditions, and ensure the corporate values and culture are better understood. Some companies have recognised that codes alone will not provide the 'reputation protection' they seek, and are introducing their own factory-based training in countries like China. In some cases (for example, Pentland, Reebok, Levi Strauss, Adidas-Salomon and Nike), they are working with NGOs and specialist consultants to deliver broader training which includes communication skills, occupational health and safety and HIV/AIDS awareness.

Stakeholder engagement processes

In addition to international training initiatives, within Australia there is a growing trend by larger enterprises, particularly banks, to establish 'stakeholder engagement panels'. The best examples are those with a clear agenda and capacity for civil society representatives to share their expertise and feel confident that they are making a difference. Less desirable are the 'quick fix' short meetings which do little more than launch a triple bottom line report and seek endorsement from recognised community groups.

The key objective should be to ensure meaningful discussions and create real opportunities that will benefit all participants and will not simply appropriate community sector knowledge and language. 'Stakeholder fatigue' is a concern of some community participants in these programs.

B) Corporate responsibility and accountability to stakeholders – what needs to happen in the future?

Organisational decision makers need to have regard for the interests of all stakeholders in the context of a global economy. This applies to operations both in Australia and in other countries, including where goods and services are sourced. The broader obligations and responsibilities of directors and management should include promoting responsible social and environmental practices that minimise any adverse impact on the natural environment, local communities and employees, including those in non-OECD countries and conflict zones.

Business ethics and corporate awareness of CSR must be planned and implemented to protect the long-term reputation of the firm and to comply with local laws and international best practice with regard to business and human rights. However, this needs to be seen as an integral part of the governance framework, not an additional or secondary responsibility. Decision makers and directors should ensure the development of internal programs, guidance and management systems that underpin a corporate culture that is committed to good corporate citizenship, ethical procurement and good business and employee conduct. This is particularly important in non-OECD countries and developing countries that may not have a strong institutional or regulatory framework.

Management and operational systems should pay serious attention to:

- knowledge of relevant labour laws and practices in all countries of operation
- transparent supply chains, production networks, licensing arrangements and portfolio investments
- public documentation of suppliers
- environmental impact assessments
- knowledge and documentation of any adverse impact on local communities

- ethical sourcing and procurement practices
- compliance with international standards (e.g. OECD Guidelines for Multinational Enterprises)
- protection of fundamental human rights in the workplace.

Directors also have a responsibility to promote the positive contributions that enterprises can make to economic, environmental and social progress, and minimise the negative impacts. Consideration must be given to:

- sustainable development and foreign direct investment
- efficient use of capital, technology, human and natural resources
- transfer of technology
- development of human capital
- greater coherence between the social, economic and environmental objectives
- promotion of human rights.

C) Limitations of 'directors duties' in achieving corporate responsibility

This inquiry provides an opportunity to acknowledge the vital role of the Board of Directors in strategic thinking and planning of enterprise operations. What is required is a legal framework that encourages proactive, innovative, sustainable practices that exceed the stated legislative and fiduciary duties requirements, and contribute to wealth creation benefits in the broadest sense.

The Corporations Act identifies directors as accountable to the company, and indirectly to shareholders. In effect, the Act may discourage them from having regard for the interests of stakeholders other than shareholders and the broader community. This is inadequate and does not meet international principles of corporate governance, or contribute to a corporate culture that values responsible business practices. Further, it does not recognise the responsibilities and obligations of directors and enterprises acting in both domestic and international environments where adequate laws may not exist, particularly in developing countries and conflict zones. In the current context, directors must ensure the enterprise's activities are consistent with international treaties and voluntary corporate social responsibility mechanisms. Further, the board's accountability should include not only company's auditors and shareholders, but also stakeholders and communities affected by the company's activities wherever it operates.

Directors have community obligations to promote corporate social responsibility, create an ethical business culture, apply high ethical standards and act with due diligence and care. Directors' responsibilities should be expanded to include oversight of:

- responsibilities to local communities in all countries, including conflict zones
- the human rights implications of business decisions
- the social and environmental implications of business decisions
- responsibilities to stakeholders other than shareholders and to the broader community
- role and responsibilities of financial intermediaries and portfolio investments
- greater disclosure on cross-border activities, including supply chain, production network and licensing transparency and accountability
- development and implementation of processes to ensure compliance with local laws and international standards
- development of a corporate culture that values ethical business practices and CSR.

D) Revision of the Corporations Act

The corporate governance framework should be developed with a view to both compliance with local laws (both in Australia and overseas) and international standards, and the development of a corporate paradigm that promotes and values an ethical corporate culture. This will necessitate considerating the overall impact on local communities, and must encompass the social and environmental principles of CSR.

The links between sustainable foreign direct investment and corporate governance must be made and documented in the Act. In particular, additional reference should be made to cross-border responsibilities regarding transparent investment and capital flows and related trade and services, including supply chain management. This is applicable in both OECD and non-OECD countries. The corporate governance framework must recognise the rights of all stakeholders and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound and socially responsible enterprises.

To achieve this, the Corporations Act must identify the internationally recognised treaties, standards and mechanisms that form part of the global corporate governance framework. These include:

- ILO Declaration on Fundamental Rights at Work
- UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights
- OECD Guidelines on Multinational Enterprises
- OECD Principles of Corporate Governance
- OECD Convention on Combating Bribery of Foreign Public Officials in International Transactions
- UN Universal Declaration of Human Rights
- Rio Declaration on Environment and Development; and
- UN Global Compact.

The commentary of the Act must be developed to promote mechanisms and incentives that require the Board to exceed their legal requirements in daily operations. Further, stakeholders need to be recognised as potential whistleblowers: accordingly, they need to be able to raise concerns and be assured of adequate protection.

The Corporations Act must ensure that timely and accurate disclosure is made to all shareholders and stakeholders on all matters regarding the corporation, including the financial situation, performance, ownership and social, environmental and human rights governance of the company. Disclosure should be consistent with the OECD Guidelines for Multinational Enterprises, to which the Corporations Act should make reference. These Guidelines have an implementation mechanism that provides opportunities for stakeholders to raise specific instances that may be at odds with the Guidelines for investigation and comment by the appropriate National Contact Point.

E) Alternative mechanisms to enhance CSR

In addition to the Australian Corporations Act, there are numerous complimentary internationally recognised instruments that are relevant to a company's decision-making processes concerning areas such as the environment, anti-corruption or ethical concerns.

Transnational corporations and other business enterprises, their offices and persons working for them are obligated to respect the widely recognised responsibilities and norms contained in the UN treaties and other international instruments. The International Labour Organization (ILO) Declaration on Fundamental Rights at Work is often cited as the appropriate benchmark for core labour standards. However, a significant challenge for enterprises is how to interpret and operationalise these standards, which are addressed to nation states.

Although many of the international mechanisms which form the basis of most CSR standards are non-binding, they do in fact carry a degree of moral authority. The recently developed OECD Guidelines for Multinational Enterprises are currently the highest set of standards available amongst the global corporate, social and environmental responsibility instruments. They are the most important code of conduct that exists for business, and they provide for citizens to raise concerns about the practices of international companies with the home government. They are unique in that they have the support of the business, trade union and NGO sectors, although there are still significant barriers to their successful implementation. In addition, the Guidelines allow 'specific instances' to be raised, investigated and reported on.

Implementation of the Guidelines in non-adhering countries such as China is problematic; however, opportunities do exist for enterprises to pursue CSR. Complex subcontracting and supply chain arrangements make application of the Guidelines more difficult, but there is a role for home governments in supporting those enterprises seeking to do the right thing. For example, in Australia, Austrade and the Export Finance and Insurance Corporation can assist firms, particularly small and medium-sized enterprises, to understand the realities of sustainable and socially responsible investment in developing countries.

To assist companies, governments need to make the connections between human rights and international business, and to accept some responsibility for the business activities of enterprises abroad to contribute to compliance with labour and environmental standards. They can play a significant role in persuading enterprises to improve their transparency and accountability, particularly in their global production networks, licensing arrangements and portfolio investments.

Other complimentary mechanisms that must be considered include:

- UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights
- OECD Principles of Corporate Governance
- OECD Convention on Combating Bribery of Foreign Public Officials in International Transactions
- Rio Declaration on Environment and Development
- UN Global Compact.

As outlined in section A above, the proliferation of codes of conduct (SA 8000, Ethical Trading Initiative, company-specific, industry-specific, etc.) is a direct response to a growing awareness of CSR, but is more closely linked to risk management strategies. While codes of conduct can be a useful first step in harnessing an enterprise's commitment to CSR, particularly when accompanied by a meaningful, independent monitoring and compliance, they cannot be relied on to guarantee ethical business practices.

Other more innovative mechanisms appear to be having more effect on the practices of some enterprises which have been involved in CSR, both domestically and internationally. These include:

- mapping the supply chain and documenting conditions and impact on all stakeholders
- multi-stakeholder initiatives
- training and capacity building projects
- engagement processes and partnership

- ethical procurement and purchasing strategies
- linking CSR to competitive advantage and 'smart business'.

The significant challenge facing advocates of CSR is that the current 'framework' consists of predominantly voluntary mechanisms. This means that their effectiveness is limited, and civil society representatives and lobby groups are increasingly calling for enforceable intergovernmental regulation to ensure greater corporate accountability and ethical business practices. There has been a gradual hardening of approaches, moving from those that rely on corporate self-regulation to co-regulation and multi-stakeholder initiatives (Utting 2005).

In considering regulatory, legislative or other policy options, the Inquiry should give consideration to Utting's report, *Rethinking business regulation: from self-regulation to social control*, and in particular pages 22–5, which outline the range of voluntary and legal approaches to CSR implementation and regulation.

F) Monitoring, compliance and reporting

Monitoring codes of conduct and reporting effectively are a major challenge for enterprises. As outlined in section A, it is not always easy to find suitably trained, independent auditors to monitor company codes, particularly in developing countries with poor regulatory environments and complex local laws. Regulation, monitoring and compliance remain perhaps the most challenging aspect of CSR.

There has been a slow but steady increase in the use of the Global Reporting Initiative (GRI) as a reporting tool. This has been enhanced by work of the OECD Investment Committee and representatives of GRI to ensure greater synergy between the OECD Guidelines for Multinational Enterprises and the GRI to promote CSR. The Ethical Trading Initiative also has an annual and cumulative reporting mechanism to encourage incremental improvements in CSR practices. However, the reality is that these initiatives involve only a small number of transnational enterprises (TNC) and their suppliers, and there is a great deal of work to be done to gain the involvement of more enterprises.

The number of enterprises who produce TBL or sustainability reports is relatively small. However, of greater concern is the growing trend to again produce these reports as part of a risk management strategy. BSL research (Holm & Lillywhite 2002) confirmed that many enterprises simply document their legal obligations (e.g. providing a safe workplace and training opportunities) as evidence of their capacity to meet their 'social' obligations. Few enterprises document their offshore activities, supply chains, conditions under which good and services are procured and any adverse effect their activities may be having on local communities. Many such reports are little more than marketing or public relations exercises. However, like codes of conduct, they are a useful tool in harnessing an organisation's commitment to CSR and they can begin the process of reporting on business operations beyond just financial performance.

G) A global approach to CSR

Research undertaken by the BSL suggests that the most effective way to tackle CSR is through a coordinated approach involving global collaboration between government, business, trade unions and civil society. Industry associations and professional bodies have a role to play in ensuring that organisational decision makers are meeting the needs of all stakeholders and promoting ethical business practices. The Commission of the European Communities has responded to the need for a collaborative approach. It has affirmed that 'the recognition that sustainable economic growth goes hand in hand with social cohesion—which implies respect for core labour standards—now underpins the strategic and social policy goals of the Economic Union' and that 'global market governance has developed more quickly than global social governance' (2001, p.4).

In an operational context, long-term meaningful relationships with suppliers, encouraging discussion of CSR and opportunities to work in partnership, are most likely to facilitate good CSR practices. Further, incentive schemes that link export finance and insurance programs to good CSR practices will assist in strengthening the governance framework.

There are a growing number of innovative policy responses to promote CSR. Across the US and Canada, local governments have declared 'no sweat' cities or communities, ensuring that uniform and other garments are not sourced from factories with poor labour conditions. As a result, many companies publicly announced the location and complexity of their supply chain. The State of New York adopted an anti-sweatshop bill in 2002, and directed the State University of New York and City University of New York to procure their apparel from suppliers and manufacturers who comply with international labour standards (for further information, see <www.labor-religion.org>).

In Umbria in central Italy, a procurement regulation has been developed which gives priority and contracts to companies that are SA 8000 certified, and France now requires all nationally listed corporations to report to shareholders and stakeholders on corporate social responsibility issues including labour practices (for further information, see <www.maquilasolidarity.org>).

The recent report by Utting gives a good overview of the rapidly evolving CSR agenda, and of developments through both voluntary and regulatory arrangements that place greater emphasis on corporate obligations, legal frameworks and implications for non compliance. Multi-stakeholder initiatives have resulted in a small but influential shift away from corporate self-regulation to greater dialogue and collaborative regulation.

Conclusion

This submission draws attention to the international dimensions of CSR. In particular, it suggests that any changes to the Corporations Act recognise the global dimensions of business, and the fact that most companies are operating in a range of jurisdictions. This adds to the complexity of CSR and warrants a range of responses considering business impact on all stakeholders, including local communities and supply chains. It suggests this is best achieved by developing and implementing systematic business processes and a corporate culture that values ethical practices. Organisational decision makers can play a key role in ensuring this occurs, and these broader responsibilities should be acknowledged the Corporations Act.

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For further information regarding this submission, please contact
Serena Lillywhite
Manager, Ethical Business

Brotherhood of St Laurence
67 Brunswick Street
Fitzroy Vic 3065

Ph: (03) 9483 1379
E-mail: slillywhite@bsl.org.au

human rights
law resource centre

Human Rights and Corporate Social Responsibility

Submission to the Corporations and Markets Advisory Committee Inquiry into Corporate Social Responsibility

February 2006

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Corporate Social Responsibility

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Inquiry into Corporate Social Responsibility

Philip Lynch

Human Rights Law Resource Centre Ltd
Level One, 550 Lonsdale Street
Melbourne VIC 3000

Tel: (03) 9225 6695
Fax: (03) 9225 6686
Email: hrlrc@vicbar.com.au

Table of Contents

1. EXECUTIVE SUMMARY 5

1.1 Overview 5

1.2 Findings 5

1.3 Recommendations 6

2. INTRODUCTION 8

2.1 About the Human Rights Law Resource Centre Ltd 8

2.2 Overview of Submission 8

2.3 What is 'Corporate Social Responsibility'? 10

2.4 The 'Public Value' and 'Public Interest' in Promoting Corporate Social Responsibility 11

3. WHAT SHOULD CORPORATIONS DO ABOUT CORPORATE SOCIAL RESPONSIBILITY? 12

3.1 Overview 12

3.2 The Value of a Human Rights Approach to Corporate Social Responsibility 12

3.3 The UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights 13

3.4 Other Norms and Frameworks 15

4. WHAT ARE AUSTRALIAN CORPORATIONS DOING ABOUT CORPORATE SOCIAL RESPONSIBILITY? 17

4.1 Overview 17

4.2 Corporate Social and Environmental Activity and the Corporate Responsibility Index 17

5. WHAT CAN AUSTRALIAN CORPORATIONS DO ABOUT CORPORATE SOCIAL RESPONSIBILITY? 19

5.1 Introduction 19

5.2 The *Corporations Act* and the Obligation to Act in the Best Financial Interests of Shareholders 19

5.3 Corporate Social Responsibility and the Best Financial Interests of Shareholders 20

6. EXPLAINING THE GAP BETWEEN WHAT AUSTRALIAN CORPORATIONS CAN AND SHOULD DO ABOUT CORPORATE SOCIAL RESPONSIBILITY 22

6.1 Overview 22

6.2 Restrictions Imposed by the *Corporations Act*......22

6.3 Lack of Incentives and Absence of Disincentives......22

7. BRIDGING THE GAP BETWEEN WHAT CORPORATIONS CAN AND SHOULD DO ABOUT CORPORATE SOCIAL RESPONSIBILITY......23

7.1 Overview......23

7.2 Permissive Regulation......23

7.3 Proscriptive Regulation......23

7.4 Reporting and Disclosure Requirements......25

7.5 Market Indices and Certification Programs......26

7.6 Governmental Incentives to Corporate Social Responsibility......26

7.7 Consumer Advocacy and Mobilisation......27

8. CONCLUSION......29

9. BIBLIOGRAPHY......30

9.1 Books, Journal Articles and Reports......30

9.2 Newspaper Articles and Press Releases......31

9.3 Cases and Jurisprudence......31

9.4 Legislation, Declarations and Treaties......32

1. Executive Summary

1.1 Overview

This Paper examines the nature, extent, scope and incidence of corporate social responsibility in Australia. It also considers the legislative and policy frameworks that variously encourage or discourage corporations with respect to conducting their business and affairs in a socially and environmentally responsible and sustainable way.

The Paper concludes that current frameworks do not promote, and in some instances, constitute obstacles to, corporate social responsibility. Given the capacity of corporations and corporate conduct to either promote or derogate human rights and social, environmental and community interests, the Paper proposes a range of legislative and policy initiatives – including in relation to directors' duties, reporting and disclosure requirements, and government procurement – to ensure that corporations consider the interests, values and rights of stakeholders and the broader community.

1.2 Findings

- In this Paper, the term 'corporate social responsibility' is used to refer to corporate decision-making, management, practice, performance and reporting which is:
  - ethical;
  - sustainable; and
  - has regard to local, social, community and environmental interests as well as financial considerations.
- The impact and influence of corporate activity is significant, widespread and increasing. Corporations have the capacity to foster economic well-being, development, technological improvement and wealth, as well as the capacity to impact harmfully on the human rights and lives of individuals and communities. Recognising these impacts and spheres of activity and influence, particularly as they pertain to the realisation of fundamental human rights, there is a strong public interest in the conduct of business and corporate affairs to impact positively not only on relevant financial interests, but also on relevant social and environmental interests.
- While the extent of corporate social responsibility in Australia has increased significantly over the last decade, it still remains low. Less than 10 per cent of corporations demonstrate a developed understanding of the relationship between corporate social responsibility and business.
- There is a manifest need for policy and incentives to promote corporate social responsibility and encourage companies to contribute to the realisation of human rights within their spheres of activity and influence.
- Section 181 of the *Corporations Act*, which requires directors to act in good faith in the best interests of the company and for a proper purpose, only permits corporations to have regard to, and act in the interests of, social, environmental and broader community interests in so far as those interests are related to, or likely to bear on, the financial interests of shareholders.

Further, while there is an emerging body of evidence demonstrating a positive correlation between corporate social responsibility and shareholder value, the *Corporations Act* requires that social and environmental interests be subverted to shareholders' financial interests where those interests are not consonant.

- Recognising the links between public values and interests, corporate activity and the realisation of universal human rights, corporate social responsibility should be promoted, regulated and evaluated within a human rights framework.
- The *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* developed and approved by the UN Sub-Commission on the Promotion and Protection of Human Rights in 2003 are the most comprehensive, clear and complete standards developed in relation to socially responsible corporate behaviour.

1.3 Recommendations

Recommendation 1

Section 181 of the *Corporations Act* should be amended to positively require directors to consider stakeholder interests and social, environmental and human rights concerns in the exercise of directors' duties.

Recommendation 2

The *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* should be legislatively enacted in Australia. Consistently with the *Draft Norms*, this legislation should:

- enshrine, and impose obligations of realisation on corporations in relation to, relevant human rights, including: the right to equal opportunity and non-discriminatory treatment; the right to security of persons; the rights of workers and their families; consumer rights and protections; and environmental rights and standards;
- require corporations to recognise and respect the 'public interest', 'development objectives' and principles of 'transparency' and accountability';
- require corporations, within their respective spheres of activity and influence, to promote, secure the fulfilment of, respect, ensure respect for and protect human rights;
- require corporations to develop and implement operating procedures that are compliant with the *Draft Norms*;
- encourage corporations to consult with stakeholders and communities about their activities, influence and impact;
- encourage corporations to engage in business only with other corporations, entities and natural persons that comply with the *Draft Norms*;
- encourage corporations to apply and incorporate the *Draft Norms* into contracts and other arrangements with other corporations, entities and natural persons; and

- require corporations to report at least annually on their activities, operation and performance in relation to implementation of the *Draft Norms* and social and environmental impacts.

Recommendation 3

The ASX Listing Rules and the ASX Principles of Good Corporate Governance and Best Practice Recommendations should be amended to promote corporate operation and performance in accordance with the *Draft Norms*.

Recommendation 4

The Australian Securities and Investment Commission should be empowered to monitor and enforce reporting and disclosure in relation to implementation and application of the *Draft Norms*.

Recommendation 5

The Australian Stock Exchange should consider developing a market index that measures the performance of companies against the *Draft Norms*.

Recommendation 6

The Australian Government should consider providing resources for the establishment and operation of a standards and verification scheme based on the *Draft Norms* which provides certification to corporations compliant with those Norms.

Recommendation 7

The Australian Government should only procure from, and contract with, corporations, other business entities and natural persons that comply with the *Draft Norms*.

2. Introduction

2.1 About the Human Rights Law Resource Centre Ltd

The Human Rights Law Resource Centre Ltd ('HRLRC') aims to promote human rights in Victoria and Australia, particularly the human rights of people that are disadvantaged or living in poverty, through the practice of law. The HRLRC seeks to achieve this aim by supporting, conducting, coordinating, resourcing, facilitating and enhancing the provision of legal services, litigation, education, training, research and advocacy regarding human rights.

The HRLRC undertakes these activities through partnerships and collaboration with the community legal sector and legal aid, human rights organisations, pro bono lawyers, legal professional associations and university law schools.

The HRLRC is the first specialist human rights law resource centre in Australia. It is also the first centre to pilot an innovative service delivery model to promote human rights. The model draws together and coordinates the capacity and resources of pro bono lawyers and legal professional associations, the human rights law expertise of university law schools, and the networks, grass root connections and community development focus of community legal centres and human rights organisations.

The HRLRC was formally incorporated in January 2006 with the Public Interest Law Clearing House (Vic) Inc ('PILCH') and the Victorian Council for Civil Liberties Inc ('Liberty Victoria') as the initial members. PILCH is an independent community legal centre that facilitates the provision of pro bono legal services to marginalised and disadvantaged individuals, groups and communities. Liberty Victoria is an incorporated association whose activities include human rights-focused community and professional legal education, law reform, lobbying and advocacy.

2.2 Overview of Submission

In recent months, the issue of corporate social responsibility has become a 'hot topic'.

The trend towards companies engaging in, or at least being seen to engage in, socially responsible conduct was evident in the response of Australian businesses to the Indian Ocean tsunami on 26 December 2004. Many corporations made substantial contributions to support aid efforts and relief work in tsunami-affected areas. The trend has also been reflected in business performances in the Australian Corporate Responsibility Index, a voluntary measurement tool which assesses the performance of participating companies against a range of social and environmental criteria. Between 2003 and 2004, the overall average score of companies ranked by the Index increased from 77 per cent to 81.88 per cent.[1]

The trend has not, however, been universal or without controversy. Following the significant corporate response to the tsunami, the Australian Shareholders Association publicly questioned whether, in the context of the duty of directors to 'act in the best interests of the company's shareholders', such donations were appropriate or legal.[2] Similarly, while the overall performances of companies in the Corporate Responsibility Index have improved, participation

[1] 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005.

[2] Malcolm Maiden, 'Tsunami: The Backlash', *The Age* (Melbourne), 12 February 2005.

rates remain very low; only about 1.5 per cent of ASX-listed companies participate in the annual survey.

In addition to being a topic of public debate and media commentary, the issue of corporate social responsibility has also recently become a subject of policy analysis and consideration. On 23 March 2005, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, referred the issue of directors' duties and corporate social responsibility to the Corporations and Markets Advisory Committee ('CAMAC').[3] CAMAC has been asked to consider the extent to which the duties of directors under the *Corporations Act 2001* (Cth) should include corporate social responsibilities or explicit obligations to take account of the interests of certain classes of stakeholders other than shareholders. Finally, on 23 June 2005, the Parliamentary Joint Committee on Corporations and Financial Services was asked to inquire into 'corporate responsibility and triple-bottom line reporting for incorporated entities in Australia'.[4] The inquiry will consider the nature and extent of corporate social responsibility and examine mechanisms, including legislative, regulatory and policy mechanisms, to promote and enhance corporate consideration of the interests of stakeholders (other than shareholders) and the broader community.

This Paper begins at Part 2 by defining and discussing the term 'corporate social responsibility', with particular reference to the Australian context. Part 2 also discusses the public interest and public value associated with socially responsible corporate behaviour and, by extension, the desirability of public policy frameworks and initiatives to promote corporate social responsibility.

Part 3 of the Paper looks at what corporations should do and should be able to do in terms of behaving in a socially responsible way. It argues that there is a strong link between corporate conduct and social and environmental wellbeing. Recognising this association, and the need for a normative value framework within which to regulate and evaluate such conduct, Part 3 proposes a human rights framework based on the *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* for the engagement of corporate social responsibility and the promotion and evaluation of socially responsible corporate conduct.

While Part 3 of the Paper focuses on what corporations should do and should be able to do in the area of corporate social responsibility, Parts 4 and 5 of the Paper looks at what corporations are doing and can do in terms of behaving in a socially responsible way. Informed by the recently released Corporate Responsibility Index 2004, Part 4 of the Paper considers what corporations are doing about corporate social responsibility, including by examining the nature and extent of socially responsible corporate behaviour in Australia. Part 5 of the Paper then discusses the legislative and policy frameworks, including the *Corporations Act*, governing the conduct and behaviour of corporations in Australia and examines the ways in which these frameworks promote or fetter socially responsible corporate behaviour.

Recognising the importance of identifying obstacles and impediments to the attainment of desirable policy outcomes, Part 6 of the Paper discusses the reasons for the gap between, on the

[3] Parliamentary Secretary to the Treasurer, Commonwealth of Australia, 'Pearce Announces Integrated Approach to Insolvency Law Reform' (Press Release No 9, 22 March 2005), <http://parlsec.treasurer.gov.au/cjp/content/pressreleases/2005/009.asp> at 30 June 2005.

[4] Parliament of Australia, 'Inquiry into Corporate Responsibility', <http://www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/index.htm> at 28 June 2005.

one hand, what corporations are doing and can do in the area of corporate social responsibility and, on the other hand, what corporations should do and should be able to do.

Part 7 of the Paper then discusses a range of public policy initiatives, including international initiatives, designed to bridge these gaps. Each initiative is analysed in the context of its potential to authorise, and create incentives in relation to, companies engaging in socially responsible conduct that seeks to promote and protect human rights.

Part 8 of the Paper concludes that a range of local, national and international initiatives, including of a legislative, regulatory and financial nature, are needed to ensure realisation of the public interest in corporations conducting their business and affairs in a way that promotes and protects human rights.

2.3 What is 'Corporate Social Responsibility'?

There is no universally accepted definition of corporate social responsibility.

In its broadest and most common sense, the term 'corporate social responsibility' is used to describe corporate conduct which is ethical and has regard to social and environmental interests as well as financial considerations. Thus, for example, the World Business Council for Sustainable Development defines corporate social responsibility as the 'commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life'.[5] In this context, socially responsible corporate conduct is conduct which recognises that corporations have relationships with, and impacts on, not only shareholders but also other stakeholders (including employees, their families, business partners, suppliers, creditors, consumers and local communities), the broader community and the environment. According to the Australian Corporate Responsibility Index, this requires that principles of corporate social responsibility inform the development of corporate strategy and values, be integrated into corporate decision-making and behaviour, form an integral component of management practice and stakeholder engagement, be reflected in corporate performance and impact, and be identified in corporate measurement, reporting and disclosure.[6]

Having regard to the above, for the purpose of this Paper, the term 'corporate social responsibility' will be used to refer to corporate decision-making, management, practice, performance and reporting which is:

- ethical;
- sustainable; and
- has regard to local, social, community and environmental interests as well as financial considerations.

[5] Richard Holme and Phil Watts (World Business Council for Sustainable Development), *Corporate Social Responsibility: Making Good Business Sense* (2000) 10. See also Phil Watts and Richard Holme (World Business Council for Sustainable Development), *Meeting Changing Expectations: Corporate Social Responsibility* (1999) 3.

[6] 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005, 2.

2.4 The 'Public Value' and 'Public Interest' in Promoting Corporate Social Responsibility

In his reference to CAMAC in relation to directors' duties and corporate social responsibility, the Hon Chris Pearce MP wrote:

> In modern society, a great deal of business and other activities are conducted by corporate entities. Given the broad economic, social and environmental impact of these activities, there is an understandable interest in the legal framework in which corporations make decisions.[7]

The impact and influence of corporate activity is significant, widespread and increasing. Developments in the areas of globalisation, privatisation, corporatisation and information technology mean that businesses have the potential and power to impact substantially on local, regional, national and even international communities and environments.[8] Increasingly, corporations are involved directly in production and service delivery which impacts very directly on individual and community welfare, including in the areas of employment, occupational health and safety, transport, essential services such as energy and water, housing, food, education, communications, recreation, and environmental wellbeing and sustainability.[9] As the UN Sub-Commission on the Promotion and Protection of Human Rights recognises:

> Corporations and other business enterprises have the capacity to foster economic well-being, development, technological improvement and wealth, as well as the capacity to cause harmful impacts on the human rights and lives of individuals through their core business practices and operations, including employment practices, environmental policies, relationships with suppliers and consumers, interactions with Governments and other activities.[10]

Recognising these impacts and spheres of activity and influence, particularly as they pertain to the realisation of fundamental human rights, there is a strong public interest in, and value associated with, the conduct of business and corporate affairs to impact positively not only on relevant financial interests, but also on relevant social and environmental interests.

[7] Corporations and Markets Advisory Committee, 'Reference in Relation to Directors' Duties and Corporate Social Responsibility' (March 2005) <http://www.camac.gov.au/CAMAC/camac.nsf/byHeadline/Whats+NewDirectors%27+duties+and+corporate+social+responsibility?openDocument> at 29 June 2005.

[8] See generally, Amnesty International, *Submission by Amnesty International under Decision 2004/116 on the 'Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights* (2004) 1 <http://www.ohchr.org/english/issues/globalization/business/docs/amnesty.doc> at 29 June 2005.

[9] See, eg, Adolfe Berle and Gardiner Means, *The Modern Corporation and Private Property* (2nd ed, 1967) 309-13.

[10] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003). See also UN Sub-Commission on the Promotion and Protection of Human Rights, *Report of the United Nations High Commissioner on Human Rights on the Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights,* [24], UN Doc E/CN.4/2005/91 (2005).

3. What Should Corporations Do About Corporate Social Responsibility?

3.1 Overview

This Part of the Paper examines what corporations should do and should be able to do in terms of behaving in a socially and environmentally responsible and sustainable way. It argues that corporate conduct impacts significantly on social and environmental wellbeing and that there is a need for a normative value framework within which to regulate and evaluate this conduct. Recognising the links between public values and interests, corporate activity and the realisation of human rights, it proposes a human rights framework for the engagement of corporate social responsibility and the promotion and evaluation of socially and environmentally responsible corporate conduct.

3.2 The Value of a Human Rights Approach to Corporate Social Responsibility

Sound public policy is founded on strong evidence and is responsive to public and stakeholder preferences, interests and values.[11]

This Paper adopts a 'human rights approach' to identifying and articulating what corporations should do about corporate social responsibility and how corporations should conduct their business and affairs in a socially responsible manner.[12]

This approach has been chosen for four key reasons.

First, the human rights framework is universal and founded on a set of agreed core minimum standards with respect to the conduct of governments, enterprises and individuals. As the United Nations Office of the High Commissioner for Human Rights has asserted:

> The human rights approach offers an explicit normative framework — that of international human rights. Underpinned by universally recognized moral values and reinforced by legal obligations, international human rights provide a compelling normative framework for the formulation of national and international policies.[13]

Second, the human rights framework focuses attention on basic enabling conditions, the realisation of which are necessary for people to live with human dignity and to participate in and contribute to civil, political, economic, social and cultural life.[14] The framework also focuses

[11] See generally, Geoff Mulgan and Andrea Lee, *Better Policy Delivery and Design: A Discussion Paper* (2001); Mark Moore, *Creating Public Value: Strategic Management in Governance* (1995); Gerry Stoker, *Public Value Management (PVM): A New Resolution of the Democracy/Efficiency Tradeoff* (2003) <http://www.ipeg.org.uk/Paper%20Series/PVM.pdf> at 1 July 2005.

[12] See generally, Eugene Bardach, *A Practical Guide for Policy Analysis: The Eightfold Path to More Effective Problem Solving* (2000) for a discussion as to the importance of selecting and defining evaluative criteria to analyse and assess policy alternatives and outcomes.

[13] UN Office of the High Commissioner for Human Rights, *Human Rights and Poverty Reduction: A Conceptual Framework* (2004) 33. See also Ingrid Barnsley, (Centre for International and Public Law, Australian National University) cited in Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Code of Conduct Bill 2000* (2001) 18-19.

[14] See generally, Amnesty International, *Submission by Amnesty International under Decision 2004/116 on the 'Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights* (2004) 2 <http://www.ohchr.org/english/issues/globalization/business/docs/amnesty.doc> at 29 June 2005.

attention on the various civil, political, economic, social and cultural impacts and spheres of influence of corporations.[15]

Third, as well as enshrining rights, the international human rights framework also imposes responsibilities and obligations of realisation in relation to those rights. Implementation obligations imposed by the human rights framework on both ratifying governments and, arguably, corporations operating within their jurisdictions, include obligations to respect human rights (that is, refrain from interfering, directly or indirectly, with enjoyment of human rights), protect human rights (that is, prevent third parties, such as business partners or suppliers, from interfering in any way with the enjoyment of human rights) and fulfil human rights (in this context, take positive steps to promote and support the realisation of human rights within the relevant corporate spheres of activity and influence).[16]

Fourth, in addition to providing an important and useful framework to identify corporate impacts and impose obligations relating to the realisation of the civil, political, economic, social and cultural determinants of individual and community wellbeing, the human rights framework also enshrines important principles of human rights-based corporate management, stakeholder engagement and conduct, requiring that corporate programs and services be:

- fair and non-discriminatory — this requires that corporations and business enterprises ensure equality of opportunity and treatment;
- consultative, participatory and empowering — this requires that corporations consult with, and enable the participation of, stakeholders and individuals and communities affected by their business affairs and conduct; and
- transparent and accountable — this requires that corporations measure, report on and account for their social and environmental activities and impacts.[17]

3.3 The UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights

The *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*[18] (‘*Draft Norms*’), developed and approved by the UN

[15] See generally, Eugene Bardach, *A Practical Guide for Policy Analysis: The Eightfold Path to More Effective Problem Solving* (2000) for a discussion as to the importance of projecting outcomes and anticipating indirect consequences of a particular policy or program. A human rights approach to policy analysis, design and delivery requires that explicit attention be given to the impacts and outcomes of that policy on the various civil, political, economic, social and cultural determinants of wellbeing. See also Gerry Stoker, *Public Value Management (PVM): A New Resolution of the Democracy/Efficiency Tradeoff* (2003) 9 <http://www.ipeg.org.uk/Paper%20Series/PVM.pdf> at 1 July 2005.

[16] UN Committee on Economic, Social and Cultural Rights, *General Comment 15: The Right to Water*, [17]–[29], UN Doc E/C.12/2002/11 (2002). See also UN Committee on Economic, Social and Cultural Rights, *General Comment 12: The Right to Adequate Food*, 66, [15], UN Doc HRI/GEN/1/Rev.5 (2001) and UN Committee on Economic, Social and Cultural Rights, *General Comment 13: The Right to Education*, 74, [47], UN Doc HRI/GEN/1/Rev.5 (2001).

[17] UN Office of the High Commissioner for Human Rights, *Draft Guidelines: A Human Rights Approach to Poverty Reduction Strategies* (2002) 2, 4–5. See also Geoff Mulgan and Andrea Lee, *Better Policy Delivery and Design: A Discussion Paper* (2001) and Mark Moore, *Creating Public Value: Strategic Management in Governance* (1995) 10.

[18] Commission on Human Rights, *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003). For the most authoritative

Sub-Commission on the Promotion and Protection of Human Rights in 2003, are perhaps the most ‘comprehensive, clear and complete’ standards developed in relation to socially responsible corporate behaviour.[19]

The *Draft Norms* enshrine, and impose obligations of realisation on corporations in relation to, relevant human rights, including: the right to equal opportunity and non-discriminatory treatment;[20] the right to security of persons;[21] the rights of workers and their families;[22] consumer rights and protections;[23] and environmental rights and standards.[24] The *Draft Norms* also require corporations to recognise and respect the ‘public interest’, ‘development objectives’ and principles of ‘transparency’ and accountability’.[25]

In relation to implementation, art 1 of the *Draft Norms* provides that:

> Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights.

A corporation’s spheres of activity and influence will vary depending upon its size. However the spheres are clearly envisaged to have contractual, economic and geographic dimensions,[26] and to include shareholders, workers, unions, consumers, business partners, suppliers, creditors and individuals or groups directly or indirectly affected by a corporation’s activities, including host communities and neighbouring communities.[27]

While at this stage the *Draft Norms* are not legally binding, they envisage a range of operationalisation and enforcement mechanisms. These include:

- Corporations developing and implementing operating procedures that are compliant with the *Draft Norms*;[28]

exposition of the *Draft Norms*, see *Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, UN Doc E/CN.4/Sub.2/2003/38/Rev.2 (2003).

[19] UN Sub-Commission on the Promotion and Protection of Human Rights, *Report of the United Nations High Commissioner on Human Rights on the Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights,* [21], UN Doc E/CN.4/2005/91 (2005).

[20] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 2, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[21] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, arts 3, 4, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[22] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, arts 5–9, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[23] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 13, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[24] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 14, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[25] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 10, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[26] UN Sub-Commission on the Promotion and Protection of Human Rights, *Report of the United Nations High Commissioner on Human Rights on the Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights,* [37]–[38], UN Doc E/CN.4/2005/91 (2005).

[27] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 22, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[28] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 15, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

- Corporations consulting with stakeholders and communities about their activities, influence and impact;[29]
- Corporations engaging in business only with other corporations, entities and natural persons that comply with the *Draft Norms*;[30]
- Corporations applying and incorporating the *Draft Norms* into contracts and other arrangements with other corporations, entities and natural persons;[31]
- Corporations periodically (at least annually) reporting on their activities, operation and performance in relation to implementation of the *Draft Norms* and social and environmental impacts;[32] and
- Monitoring by the United Nations and relevant international and national mechanisms in relation to implementation and application.[33]

Very importantly, the *Draft Norms* are not intended in any way to displace or detract from the primary responsibility of states to promote, protect and fulfil human rights. In this respect, art 17 of the *Draft Norms* imposes on states the obligation to 'establish and reinforce the necessary legal and administrative framework for ensuring that the Norms and other relevant national and international laws are implemented by transnational corporations and other business enterprises'.

3.4 Other Norms and Frameworks

In addition to the *Draft Norms*, there are a number of other international codes and principles that seek to promote corporate social responsibility and human rights-respecting corporate conduct. Relevant instruments include:

- The *United Nations Global Compact* — the *Global Compact* is a voluntary corporate citizenship initiative which encourages corporations to, among other things, support and respect the protection of human rights and ensure that they are not complicit in human rights violations;[34]
- The *OECD Guidelines for Multinational Enterprises* — the *Guidelines* contain recommendations to business concerning corporate conduct and affairs. Relevantly, the *Guidelines* recommend that corporations 'respect the human rights of those affected by their activities';[35]

[29] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 16, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[30] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 15, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[31] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 15, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[32] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 15, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[33] *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, art 16, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[34] *UN Global Compact* (2000) <http://www.globalcompact.org> at 29 June 2005.

[35] Organization for Economic Co-operation and Development, *OECD Guidelines for Multinational Enterprises* (2000) 19 <http://www.oecd.org/dataoecd/56/36/1922428.pdf> at 29 June 2005.

- The ILO *Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy* — the ILO *Declaration* provides guidance to corporations on labour-related aspects of workers' rights, but does not direct itself to other areas of human rights.[36]

While each of these instruments is important and has contributed to the development of corporate policy and practice in the area of corporate social responsibility and human rights, the *Draft Norms* are the focus of this Paper and recommendations for three key reasons. First, they cover not only transnational corporations and multinational enterprises, but all business enterprises (whether international or domestic only) across all industries and sectors.[37] Second, the *Draft Norms* contain the most comprehensive and authoritative exposition of human rights law and its application to corporations.[38] Finally, the *Draft Norms* are expressed and intended to be mandatory in nature and to establish enforcement and complaint mechanisms and monitoring and measurement procedures.[39]

[36] International Labour Organization, *Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy* (1977) <http://www.ilo.org/public/english/standards/norm/sources/mne.htm> at 29 June 2005.

[37] Rachel Chambers, David Kinley and Sarah Joseph (Castan Centre for Human Rights), *Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights: Submission from the Castan Centre for Human Rights Law, Monash University* (2004) 1.

[38] Rachel Chambers, David Kinley and Sarah Joseph (Castan Centre for Human Rights), *Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights: Submission from the Castan Centre for Human Rights Law, Monash University* (2004) 2.

[39] Rachel Chambers, David Kinley and Sarah Joseph (Castan Centre for Human Rights), *Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights: Submission from the Castan Centre for Human Rights Law, Monash University* (2004) 3.

4. What Are Australian Corporations Doing About Corporate Social Responsibility?

4.1 Overview

This Part of the Paper discusses the nature and extent of corporate social responsibility in Australia, informed in particular by the recently released Australian Corporate Responsibility Index 2004.

4.2 Corporate Social and Environmental Activity and the Corporate Responsibility Index

It is clear that the incidence, scope and extent of socially and environmentally responsible corporate conduct and programs have increased significantly in the last decade.[40] In 2003, for example, 71 per cent of Australian corporations reported that they had developed a corporate social responsibility strategy.[41] It is less clear, however, whether and how well these programs are integrated and implemented, with only 9 per cent of corporations demonstrating a good understanding of the relationship between corporate social responsibility and business.[42]

The gap between the rhetoric and reality of corporate social responsibility is also evident in corporate engagement with, and performance on, the Australian Corporate Social Responsibility Index. The Index is a voluntary self-assessment and strategic management tool to enhance the capacity of businesses to develop, measure and communicate socially and environmentally responsible corporate conduct. It does this through benchmarking corporate social responsibility strategy and implementation processes in the areas of community, workplace, marketplace and environment.[43] The Index results in 2004 demonstrate that while some corporate social responsibility strategies and programs are becoming more developed and sophisticated (the average performance increasing from about 77 per cent to about 82 per cent between 2003 and 2004), the level of voluntary participation and engagement across corporations remains very low. Participation in the Index was limited to about 1.5 per cent of ASX-listed corporations and about 10 per cent of companies are actively invited to take part.[44] This compares with about a 30 per cent participation rate among British companies on the British Corporate Responsibility Index.[45]

Commenting on the Australian Corporate Responsibility Index, Leon Gettler has written:

[40] See, eg, UN Sub-Commission on the Promotion and Protection of Human Rights, *Report of the United Nations High Commissioner on Human Rights on the Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights,* [7], UN Doc E/CN.4/2005/91 (2005).

[41] David Grayson, ‘Value Added’ in ‘Special Report: Corporate Responsibility Index’, *The Age* (Melbourne), 4 April 2005, 3.

[42] David Grayson, ‘Value Added’ in ‘Special Report: Corporate Responsibility Index’, *The Age* (Melbourne), 4 April 2005, 3.

[43] See Corporate Responsibility Index <http://www.corporate-responsibility.com.au/default.asp> at 30 June 2005.

[44] See Corporate Responsibility Index <http://www.corporate-responsibility.com.au/default.asp> at 30 June 2005.

[45] Business in the Community, *Executive Summary: Measuring, Managing and Reporting Responsible Business Practice* (2004) 5 <http://www.bitc.org.uk/programmes/programme_directory/business_in_the_environment/bie_index/index.html> at 30 June 2005.

> There's no doubt that CSR has become an industry in its own right. But, while it provides work for public affairs divisions and consultants, questions are raised whether companies are investing more energy in giving the impression that they care than actually changing the world. Rivers are still being polluted, old growth forests are being destroyed and children are still working in plantations.[46]

Particularly in the context of the capacity of corporate activity to positively or negatively impact on the welfare and living standards of local, host and neighbouring communities, there is a manifest need for policy and incentives to, in the words of Amnesty International, 'encourage companies to contribute to the realisation of human rights within their spheres of activity and influence'.[47]

[46] Leon Gettler, 'Corporate Good Guys' in 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005, 2.

[47] Amnesty International, *Submission by Amnesty International under Decision 2004/116 on the 'Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights* (2004) 1 <http://www.ohchr.org/english/issues/globalization/business/docs/amnesty.doc> at 29 June 2005.

5. What Can Australian Corporations Do About Corporate Social Responsibility?

5.1 Introduction

This Part discusses the legislative and policy frameworks, particularly the *Corporations Act*, that govern the conduct and behaviour of corporations in Australia. It also examines the ways in which these frameworks promote or fetter socially and environmentally responsible corporate behaviour.

5.2 The *Corporations Act* and the Obligation to Act in the Best Financial Interests of Shareholders

The powers and duties of directors and, by extension, of corporations derive from both the common law and the *Corporations Act*.

Section 181(1) of the *Corporations Act* codifies the duty of directors to act:

(a) in good faith in the best interests of the corporation; and

(b) for a proper purpose.

It is well established that the term 'the best interests of the corporation' primarily means the financial interests of the company's shareholders as a general body.[48] There is some authority for the proposition that the interests of the company may include interests that are reasonably incidental to, and within the reasonable scope of carrying on, the business of the corporation (such as employees[49] and creditors[50]); however, shareholder interests remain paramount.[51]

The question as to what constitutes the exercise of a power 'for a proper purpose' requires consideration of the nature and purpose of the power conferred and whether the actual exercise of that power was, at least, substantially for that purpose.[52] A duty will not be considered to have been exercised for a proper purpose where it was exercised for a purpose collateral to that for which the power was primarily conferred and would not have been exercised 'but for' that improper or collateral purpose.[53]

Having regard to the above, it is likely that the *Corporations Act* as currently interpreted and applied only permits corporations to have regard to, and act in the interests of, social, environmental and broader community interests in so far as those interests are related to, or likely

[48] Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005) 341.

[49] See, eg, *Parke v Daily News* [1962] Ch 927 in the context of United Kingdom corporations law; and *Teck Corporation v Millar* (1973) 33 DLR (3d) 288 in the context of Canadian corporations law.

[50] *Walker v Wimborne* (1976) 137 CLR 1; *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50; *Sycotex Pty Ltd v Baseler* (1993) 13 ACSR 766; *Linton v Telnet Pty Ltd* (1999) 30 ACSR 465, 473–4.

[51] *Parke v Daily News* [1962] Ch 927.

[52] *Kokotovich Constructions Pty Ltd v Wallington* (1995) 17 ACSR 478; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Hogg v Cramphorn Ltd* [1976] Ch 254.

[53] *Kokotovich Constructions Pty Ltd v Wallington* (1995) 17 ACSR 478, 490; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285.

to bear on, the financial interests of shareholders. There is certainly no obligation on directors to take into account the interests of a broader class of stakeholders or the broader community.[54]

5.3 Corporate Social Responsibility and the Best Financial Interests of Shareholders

There is an emerging body of evidence demonstrating a positive correlation between corporate social responsibility and shareholder value.

A recent Australian-based study undertaken by AMP Capital Investors found that companies with a higher corporate social responsibility rating on the Corporate Responsibility Index outperformed the market by, on average, three per cent per annum over both four and ten year periods.[55] This is consistent with analysis undertaken in the European context by WestLB Panmure – which concluded that corporate social responsibility is an 'independent return-driving factor that can exert a positive influence on the shareholder value'[56] – and a major US study which found that there is a strong positive correlation between the social and financial performance of companies.[57]

This positive correlation seems to be attributable to two primary factors.

First, socially and environmentally responsible corporate conduct is likely to enhance corporate reputation and goodwill, both of which are 'key business assets'.[58] This is particularly the case as societal expectations of corporations trend towards ethical and responsible behaviours and outputs. As Peter Henley concludes, 'such programs use a standard business model of investment and return, and can be justified by directors as being both in the interests of the company and for a proper purpose'.[59]

Second, socially and environmentally responsible corporate conduct necessarily involves building relationships and maintaining a dialogue with a range of stakeholders — including, among others, employees, consumers, suppliers, business partners, and host and neighbouring communities — that can influence and impact upon the performance of the company. These stakeholders have a range of social and environmental interests and concerns that need to be taken into account if their engagement with, and influence and impact on, the company is to be positive.[60] On this view, corporate social responsibility is authorised by, and likely to enhance value for, shareholders in so far as it promotes a sustainable business model.

Other justifications posited for corporate social responsibility and its positive impact on shareholder value include:

[54] See generally, D F Jackson QC, *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (2004).

[55] Michael Anderson and Matthew Rey (AMP Capital Investors), 'Many Good Returns' in 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005, 3.

[56] Hendrik Garz, Claudia Volk and Martin Gilles, *More Gain than Pain: Sustainability Pays Off* (2002) 16.

[57] J D Margolis and J P Walsh, *People and Profits: The Search between a Company's Social and Financial Performance* (2001).

[58] Phil Watts and Richard Holme (World Business Council for Sustainable Development), *Meeting Changing Expectations: Corporate Social Responsibility* (1999) 9.

[59] Peter Henley, 'Were Corporate Tsunami Donations Made Legally? Some Thoughts on What Directors Can and Should be Able to Do About Corporate Social Responsibilities' (2005) 30(4) *Alternative Law Journal* (forthcoming).

- the identification of new commercial opportunities through stakeholder consultation and relationships;
- the contribution of corporate social responsibility to the building of social capital and stronger, more prosperous communities and hence consumers;[61]
- improved employee satisfaction and output;
- the avoidance of negative publicity and brand damage;[62] and
- the development of more sustainable, and hence efficient and profitable, social and environmental practices.[63]

However, despite these justifications and links, the *Corporations Act* as currently drafted, interpreted and applied would appear to require that social and environmental interests be subverted to shareholders' financial interests to the extent of any incompatibility or inconsistency.

[60] Phil Watts and Richard Holme (World Business Council for Sustainable Development), *Meeting Changing Expectations: Corporate Social Responsibility* (1999) 9.

[61] UN High Commissioner for Human Rights, *Business and Human Rights: A Progress Report* (2000) <http://www.unhchr.ch/business.htm> at 1 July 2005.

[62] David Kinley and Junko Tadaki, 'From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law' (2004) 44 *Virginia Journal of International Law* 931, 953.

[63] See generally Richard Holme and Phil Watts (World Business Council for Sustainable Development), *Corporate Social Responsibility: Making Good Business Sense* (2000) and Phil Watts and Richard Holme (World Business Council for Sustainable Development), *Meeting Changing Expectations: Corporate Social Responsibility* (1999).

6. Explaining The Gap Between What Australian Corporations Can And Should Do About Corporate Social Responsibility

6.1 Overview

Recognising the importance of identifying obstacles and impediments to the attainment of desirable policy outcomes, this Part of the Paper discusses the reasons for the gap between, on the one hand, what corporations are doing and can do in the area of corporate social responsibility and, on the other hand, what corporations should do and should be able to do. Part 7 of the Paper then looks at a range of initiatives and strategies designed to bridge these gaps.

6.2 Restrictions Imposed by the *Corporations Act*

As discussed above at Part 5.2, s 181 of the *Corporations Act* imposes a duty on companies and directors to act in the best financial interests of shareholders. There is no requirement to act in the interests of, or even have regard to, other stakeholders or social or environmental issues other than to the extent to which those interests and issues may impact on shareholder value. In fact, where the interests of shareholders and other interests, including social and environmental interests, are divergent, it is clear that directors are required to act contrary to those latter interests.

There is a clear need to amend s 181 of the *Corporations Act* to either require or permit directors to consider interests other than shareholders' financial interests in exercising and discharging corporate power.

6.3 Lack of Incentives and Absence of Disincentives

The restrictions imposed by the *Corporations Act* are compounded by the lack of incentives to socially and environmentally responsible corporate conduct and the absence of disincentives to short-term profit maximising conduct that may have deleterious social and environmental impacts and outcomes. Commenting on this, the Chief Executive Officer of ANZ Bank, John McFarlane, has said:

> When I meet with some investors, it's surprisingly unfashionable to take a platform advocating sustainability, social responsibility and community engagement. In fact, there is an argument that the pressure for short-term performance created by fund managers, competition and shrinking product lifecycles has never been greater.[64]

As there is a clear need for amendment of the *Corporations Act* to enable socially and environmentally responsible corporate conduct, there is also a clear need to create incentives to such action and disincentives to inconsistent behaviours.

[64] John McFarlane, cited in 'Follow the Leaders' in 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005, 2.

7. Bridging The Gap Between What Corporations Can And Should Do About Corporate Social Responsibility

7.1 Overview

This Part of the Paper discusses a range of public policy initiatives, including international initiatives, designed to bridge the gaps between, on the one hand, desirable corporate conduct and, on the other hand permissible and prevailing corporate conduct. Each initiative is analysed in the context of its potential to authorise, and create incentives in relation to, companies engaging in socially and environmentally responsible conduct that seeks to promote and protect human rights.

7.2 Permissive Regulation

A minimalist approach to policy and law reform to better enable corporate social responsibility would involve amending s 181 of the *Corporations Act* to permit directors to consider the interests of stakeholders other than mere shareholders in the management and operation of the company. For example, s 181 could be amended to permit consideration of the interests of employees, consumers and local communities in any exercise of corporate power or, alternatively, consideration of social and environmental interests and human rights norms. Alternatively, Peter Henley has suggested that s 181 could be amended to enable directors to have regard to the interests of stakeholders, defined as 'a person or organisation (other than a shareholder) with whom the company has or is likely to have a business or employment relationship, or who is or may become directly affected by the business of the company'.[65]

Such an approach is, however, likely to be deficient for two key reasons.

First, experience suggests that compliance with voluntary or permissive legislation or codes of conduct is likely to be limited, particularly where compliance may occasion some form of financial detriment (regardless of social or environmental outcomes) and among reticent corporations.[66] Permissive legislation tends to work best for already well-intentioned actors.

Second, where a director may be permitted, but is not required, to consider the interests of a stakeholder other than a shareholder, it is unclear whether, how and by whom such consideration could be assured or enforced.[67]

7.3 Proscriptive Regulation

An alternative approach to policy and law reform would involve amending s 181 of the *Corporations Act* to positively require directors to consider stakeholder interests or social, environmental and human rights concerns in the exercise of directors' duties. Such enactment would be likely to have normative, educative and promotional effects in relation to human rights-

[65] Peter Henley, 'Were Corporate Tsunami Donations Made Legally? Some Thoughts on What Directors Can and Should be Able to Do About Corporate Social Responsibilities' (2005) 30(4) *Alternative Law Journal* (forthcoming).

[66] Amnesty International, *The UN Human Rights Norms for Business: Towards Legal Accountability* (2004) 12.

[67] See, eg, Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005) 346.

consistent corporate conduct. Importantly, it would also be likely to act as a deterrent to inconsistent conduct, particularly if s 184 of the *Corporations Act* was concurrently amended to impose criminal liability in respect of recklessly or intentionally dishonest inconsistent conduct (as is currently the case in respect of obligations to act in the best financial interests of shareholders). Such an approach to director's duties is currently being considered in the United Kingdom, where the Government's proposed Company Law Reform Bill 2005 (UK) will include a statement of directors' duties 'which reflects modern business needs and wider expectations of responsible business behaviour'.[68] It will do this by providing that:

> the basic goal for directors should be the success of the company for the benefits of its members as a whole, but that in achieving this goal, directors must take a 'properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and the community more widely.[69]'

If enacted, the Bill will require that, in order to fulfil the duty to promote the success of the company for the benefit of its members, directors must consider:

- the consequences of any decision in both the long and the short term;
- the interests of the company's employees;
- the importance of business relationships with suppliers, customers and others; and
- the impact of its operations on the community and the environment.

This approach is consistent with the concept of 'enlightened shareholder value', which recognises that 'long-term company performance and overall competitiveness and wealth and welfare' are most likely to be maximised by socially and environmentally responsible and sustainable corporate conduct.[70]

A further alternative, which is arguably a preferable one, is a proscriptive approach which would involve legislative enactment of the *Draft Norms* to require, or at least encourage or create incentives for, all corporate activity to be consonant with the core minium standards contained therein. As the Castan Centre for Human Rights Law has argued:

> The domestic arena is the most appropriate and likely place for the Norms to obtain substantial legal effect (either before or after the Norms acquire international legal status) through the enactment of domestic law that incorporates the Norms, thereby bringing TNCs and other business enterprises within a national human rights framework.[71]

Such an approach would be consistent with federal and state legislative approaches to similar areas of interest and potential impact and concern, including occupational health and safety;[72]

[68] Department of Trade and Industry (UK), *Company Law Reform* (2005) 20 <http://www.dti.gov.uk/cld/WhitePaper.htm> at 5 July 2005.

[69] Department of Trade and Industry (UK), *Company Law Reform* (2005) 20 <http://www.dti.gov.uk/cld/WhitePaper.htm> at 5 July 2005.

[70] Department of Trade and Industry (UK), *Company Law Reform* (2005) 20–1 <http://www.dti.gov.uk/cld/WhitePaper.htm> at 5 July 2005.

[71] Rachel Chambers, David Kinley and Sarah Joseph (Castan Centre for Human Rights), *Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights: Submission from the Castan Centre for Human Rights Law, Monash University* (2004) 8, [35].

[72] See, for example, *Occupational Health and Safety Act 2004* (Vic).

discrimination and equal opportunity in employment and the provision of goods and services;[73] and environmental impact.[74] Each of these laws articulate minimum standards of conduct and enshrine certain rights in clear and accessible terms, with civil, and sometimes criminal, penalties associated with failure to adhere to the requisite standards.

7.4 Reporting and Disclosure Requirements

It is well established that mandatory measurement and disclosure requirements enhance corporate governance and conduct by ensuring a level of transparency and accountability. It is also well recognised that full disclosure and informed consumer participation is essential to the informed and fair functioning of the market. Recognising this, the ASX Listing Rules require continuous and detailed disclosure of material financial information.[75] All incorporated associations are required to report at least annually on their financial affairs.

As discussed at Part 3.3 above, art 15 of the *Draft Norms* requires corporations to report at least annually on their activities, operation and performance in relation to implementation of the *Draft Norms* and social and environmental impacts. Under Australian law there are, however, no requirements for companies to report on or disclose their social, environmental or human rights-affecting activities or impacts.[76] This can be contrasted with the position in South Africa where, for example, the JSE Securities Exchange 'Code of Corporate Practices and Conduct' requires all publicly listed companies to report in accordance with the Global Reporting Initiative Sustainability Reporting Guidelines.[77] The Guidelines require performance assessment and disclosure of economic, environmental and social policies, activities and impacts.[78]

Having regard to the above, the *Corporations Act* and, at the very least, the ASX Listing Rules should be amended to require corporate operation and performance in accordance with art 15 of the *Draft Norms*. Furthermore, in accordance with art 16, which requires monitoring by relevant national mechanisms in relation to implementation and application of the *Draft Norms*, the Australian Securities and Investment Commission should be empowered to monitor and enforce such reporting and disclosure.

[73] See, for example, *Equal Opportunity Act 1995* (Vic) Part 3, Divisions 1, 2 and 4; *Age Discrimination Act 2004* (Cth) Part 4; *Disability Discrimination Act 1992* (Cth) Part 2, Division 1 and s 24; *Racial Discrimination Act 1975* (Cth) ss 13 and 15; *Sex Discrimination Act 1984* (Cth) Part 2, Division 1 and s 22.

[74] *Environment Protection and Biodiversity Conservation Act 1999* (Vic).

[75] *ASX Listing Rules* (2004) at <http://www.asx.com.au/supervision/rules/listing/index.htm> at 30 June 2005.

[76] See David Kinley and Junko Tadaki, 'From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law' (2004) 44 *Virginia Journal of International Law* 931, 942 for a discussion of various failed corporate social responsibility bills introduced to legislatures in the US, the UK and Australia. Each of the draft bills, if enacted, would have imposed mandatory corporate social and environmental responsibility disclosure and reporting requirements.

[77] David Kinley and Junko Tadaki, 'From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law' (2004) 44 *Virginia Journal of International Law* 931, 957. See also Halina Ward, *Legal Issues in Corporate Citizenship* (2003) 3-5. In contrast, the non-mandatory ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (2003) do not contain any principles or recommendations in relation to management or disclosure having regard to social, environmental or human rights issues or impacts.

[78] See Global Reporting Initiative, 'GRI Reporting Framework' <http://www.globalreporting.org/guidelines/framework.asp> at 30 June 2005.

7.5 Market Indices and Certification Programs

The efficacy and utility of reporting and disclosure requirements, together with the social and environmental pressures that can be exerted by stakeholders, especially consumers, can be enhanced by market indices and certification programs which can transmit information about social and environmental corporate conduct in a fast, easily accessible, market-friendly way.

Recognising this, together with increased consumer interest in responsible and sustainable investment, share market sustainability indices have been developed in both the UK and the US. In the UK, the FTSE4Good Index measures the performance of companies that meet globally recognised corporate responsibility standards and thereby encourages investment in those companies.[79] Similarly, in the US, the Dow Jones Sustainability Indexes identify, measure, set benchmarks and report on corporations with respect to economic, environmental and social factors.[80]

While sustainability indices are principally directed towards, and of utility to, investors, a number of certification schemes have been developed by industries, organisations and the non-government sector to provide 'shorthand' information to consumers about the social and environmental responsibility practices of businesses. For example, the SA8000, a standards and verification scheme based on international human rights standards, provides certification to retailers and suppliers that maintain 'just and decent working conditions throughout the supply chain'.[81] Similarly, the 'Worldwide Responsible Apparel Production' program ('WRAP') is a certification program for the clothing and textile industries requiring manufacturers to comply with a range of labour rights and workplace standards.[82]

Government has an important role to play in resourcing and promoting market indices and certification programs based on social and environmental measures, including the *Draft Norms*.[83]

7.6 Governmental Incentives to Corporate Social Responsibility

Article 15 of the *Draft Norms* requires that businesses only engage with other corporations, entities and natural persons that comply with the *Draft Norms*. It further requires that corporations apply and incorporate the *Draft Norms* into contracts and other arrangements with other corporations, entities and natural persons.

While it is desirable to develop law and policy to fully enact this requirement under Australian corporate law, it is recognised that this is a longer-term project. In the shorter-term, however, there is considerable scope for local, state and national governments to use their significant 'purchasing power' to promote and even require ethical and socially and environmentally

[79] See FTSE, 'FTSE4Good Index Series' <http://www.ftse.com/ftse4good/index.jsp> at 30 June 2005.

[80] See Dow Jones, 'Dow Jones Sustainability Indexes' <http://www.sustainability-indexes.com> at 30 June 2005.

[81] See Social Accountability International, 'Overview of SA8000' <http://www.cepaa.org/SA8000/SA8000.htm> at 30 June 2005.

[82] See Worldwide Responsible Apparel Production, Website <http://www.wrapapparel.org> at 30 June 2005.

[83] Rachel Chambers, David Kinley and Sarah Joseph (Castan Centre for Human Rights), *Responsibilities of Transnational Corporations and Related Business Enterprises with Regard to Human Rights: Submission from the Castan Centre for Human Rights Law, Monash University* (2004) 9, [38].

responsible and sustainable conduct. This potential has been recognised and harnessed to some degree in Victoria where panel members on the Government's Legal Services Panel are contractually required to:

- 'commit to the furtherance of equal opportunity in their work practices (including work allocation) and in briefing barristers';
- 'comply with model litigant principles when acting on behalf of Government Clients'; and
- 'commit to provide pro bono services of at least 5 per cent of the value of the legal fees they derive under the panel arrangements'.[84]

Governmental procurement should have regard to, value and promote human rights-respecting corporate practices such as those envisaged in the *Draft Norms*.

7.7 Consumer Advocacy and Mobilisation

With the exception of proscriptive regulation and mandatory disclosure and reporting requirements, the efficacy of the various initiatives referred to above, such as market indices and certification schemes, relies on discerning investors and consumers who value corporate social responsibility. While such initiatives can have normative, educative and deterrent values and effects, most developments and progress in the area of corporate social responsibility have been driven by consumer movements and mobilisation. Thus, for example, it was the activism of Henry Spira and other members of the 'animal liberation' movement who, through a series of targeted consumer educational and advertising campaigns, pressured many cosmetics companies, such as Revlon and Proctor & Gamble, to stop animal testing.[85] Consumer movements have similarly focused attention on the corporate conduct of companies such as BHP Billiton, Shell, Nike and Reebok, with the result that some of these companies now run arguably among the most developed and sophisticated corporate social responsibility programs.[86]

However, while consumer mobilisation, movements and markets have an important role to play in the promotion of corporate social responsibility,[87] they do not obviate the need for normative regulation and intervention.[88] This is particularly the case in light of recent research indicating that in terms of consumption and investment there is often 'a difference between what consumers say and what consumers do', with economic consumption and investment often being valued over ethical consumption and investment. As the Australian Graduate School of Management has concluded, there is therefore a need for regulatory intervention to respond to the situation whereby:

[84] Department of Justice Victoria, 'Government Legal Services' <http://www.justice.vic.gov.au/CA2569020010922A/page/Business+Units-Government+Legal+Services?OpenDocument&1=0-Business+Units~&2=0-Government+Legal+Services~&3=~> at 30 June 2005.

[85] See generally, Peter Singer, *Ethics into Action: Henry Spira and the Animal Rights Movement* (1999).

[86] See, eg, Leon Gettler, 'Corporate Good Guys' in 'Special Report: Corporate Responsibility Index', *The Age* (Melbourne), 4 April 2005, 2.

[87] See also 'Uranium May Force Ethical Funds to Sell Out of BHP', *Infochoice.com.au* (Australia), 16 March 2005 <http://www.infochoice.com.au> at 1 July 2005.

[88] Robert McCorquodale, 'Human Rights and Global Business' in Stephen Bottomley and David Kinley (eds), *Commercial Law and Human Rights* (2002) 112.

> Organisations guilty of ethical breaches, wrecking the environment and trampling on human rights might damage their reputations but they might not necessarily find any consumer mandate for them to do the right thing.[89]

[89] Leon Gettler, ‘Consumers Can Be Less Than Caring’ in ‘Special Report: Corporate Responsibility Index’, *The Age* (Melbourne), 4 April 2005, 4.

8. Conclusion

Corporations have the potential and capacity to, on the one hand, contribute significantly to, and on the other hand, derogate significantly from, human rights in local, regional, national and even international communities and environments. At its best, corporate social responsibility is corporate governance and conduct that contributes to the realisation of human rights.

Current legislative and policy frameworks do not promote, and in some instances, constitute obstacles to, corporate social responsibility. A range of initiatives based on the *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, including in relation to directors' duties, reporting and disclosure requirements, and government procurement are needed to ensure that corporations consider and act in accordance with the interests, values and rights not only of shareholders but also stakeholders and the broader community.

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Macquarie University Division of Law

Law and Justice Policy Impact Project

Author: Professor Bryan Horrigan

Submission to the Australian Government Corporations and Markets Advisory Committee ('CAMAC') on Corporate Social Responsibility

(Response to CAMAC's Corporate Social Responsibility Discussion Paper, November 2005)

Submission No 1 of 2006

February 2006

Preliminary Matters

Some preliminary matters need clarifying at the outset. First, this is a submission to the Corporations and Markets Advisory Committee ('CAMAC') in response to its call for submissions in its *Corporate Social Responsibility* ('CSR') Discussion Paper in November 2005. This submission is written principally by Professor Bryan Horrigan from the Law and Justice Policy Impact Project at Macquarie University's Division of Law.[1] This submission incorporates by reference his recent publications specifically on Australia's current CSR inquiries,[2] as well as his most recent work on corporate governance and responsibility more generally.[3] It contains preliminary material for an upcoming book on corporate social responsibility for Edward Elgar Publishing Limited in the UK, entitled *Corporate Social Responsibility in Action*.

Secondly, as CAMAC and the Parliamentary Joint Committee on Corporations and Financial Services ('PJCCFS') have parallel inquiries running on CSR, it should be noted that this submission has only been prepared in time for submission to CAMAC by its early 2006 deadline, and was not available to be submitted to the parallel PJCCFS inquiry in time to meet its late 2005 deadline, as a follow-up to the author's correspondence with that committee. However, as a courtesy, a copy of this submission to CAMAC will also be sent to the PJCCFS inquiry for its information in finalizing its report.

Thirdly, some governmental bodies and parliamentary committees assert ownership-like rights over public submissions, which can sometimes present difficulties for authors in making submissions public that contain material published or to be published elsewhere. As indicated above, this submission uses and refocuses for CAMAC's needs and Terms of Reference some material that is work-in-progress for an upcoming book on CSR. Just in case it needs clarifying, none of the intellectual property or other ownership rights associated with material in this submission are being waived or relinquished, whatever other interests government bodies might claim over public submissions. However, if need be, CAMAC has permission to use and publish this submission, simply as a submission.

Fourthly, the terminology used in this submission is as follows. Unless the specific discussion indicates otherwise: 'corporate social responsibility' is referred to as 'CSR'; 'stakeholders' include 'shareholders' and 'non-shareholders'; the 'corporate constituency' includes all of a corporation's key 'stakeholders';[4] 'the UK proposal' refers to the stakeholder-sensitive reform of directors' duties introduced into the UK Parliament in late 2005; 'company' and 'corporation' are used interchangeably; and 'directors' is used generically throughout, without distinguishing between directors and other corporate officers. Most of the discussion here chiefly has large business corporations in mind.

Finally, CAMAC, the PJCCFS, and other governmental bodies and parliamentary committees receive many public submissions that involve considerable research, especially by both legal and non-legal academics who publish research, make submissions, or produce reports to assist the business of government in law reform, policy-making, parliamentary law-making, and judicial decision-making. Historically, public submissions and reports characteristically are not counted as research publications for the purpose of calculating and allocating public research funding for universities, even though they contribute to the business of government in various forms. As the Federal Government is currently preparing for implementation of a national research assessment exercise in 2007, at present research quality assumes much more significance in that exercise than research impact. Submissions like those received by CAMAC and the PJCCFS in the course of their CSR inquiries have impact through informing due consideration of policy options and arguments, and sometimes shaping ultimate policy and reform outcomes. It is in the interests of CAMAC, the PJCCFS, the government, and the public for these submissions to be made. They should be recognized for their research value, impact, and contribution to governmental policy development and law reform. Accordingly, CAMAC and the PJCCFS could consider specifically acknowledging in their reports, and communicating to those within government currently involved in developing criteria of research quality and impact for the upcoming national research assessment exercise, the valuable contribution and impact that research outputs of this kind make to Australia and its policy-making and law reform.[5]

Executive Summary

Nobody can seriously deny anymore that some global and national governance problems are inextricably linked and require cooperative solutions involving governments, business, and the community, just as business prosperity and social prosperity are inextricably linked. The question is the extent to which any of this requires changes to directors' duties, corporate reporting, and governmental policy development towards a more CSR-sensitive direction, as well as other kinds of complementary regulation and back-up support and guidance. As this submission argues, there is a sound policy case for some moderate reform.

Despite the criticisms that might be made of the shareholder-centric nature of Australian corporate law, we are not yet ready to make the leap from that to a vastly different model. At the same time, what people associate with the most worthwhile aspects of the 'shareholder primacy' norm is only part of a broader, more complete, and more coherent account of corporate responsibility, in which shareholder and non-shareholder interests and relations receive due attention. That richer account should form the basis for policy and regulatory action.

The Federal Government should undertake no reforms without first committing itself to CSR as a policy priority in government, and developing a coordinated and overarching CSR policy and regulatory framework of relevance to governmental and non-governmental organisations alike, as in the UK.

Any CSR-related clarification or change to directors' duties must be sensitive to its flow-on impact on other areas of corporate law, especially relevant 'business judgment' defences for directors. Given the present state of corporate law, the absence of a pervasive governmental policy approach to CSR, and the fact that the business community has not been on notice officially from government to lift its CSR performance, there is no sound policy basis for radically restructuring corporate law, mandating all necessary CSR changes through changes to corporate law, or creating a general CSR obligation for corporations and their directors to act in the interests of non-shareholders. At the same time, on balance there is a sound policy basis for introducing the narrower obligation of giving due consideration to non-shareholder interests, provided that the introduction of such an obligation is done with a view to the ancillary issues of regulatory guidance and liability that flow from it. If introduced, it must be introduced in the right form and in the right way. Here and elsewhere, a phased-in approach is best.

Enhanced CSR reporting obligations should be introduced, if possible, only as part of a policy and regulatory trade-off on corporate reporting generally, in which the CSR-sensitivity and meaningfulness of reported information for its intended audiences is enhanced while the overall level and detail of less meaningful reporting is reduced or otherwise streamlined. As any reform must build upon existing regulatory mechanisms, enhancement of the ASX CGC principles and recommendations on stakeholders and CSR reporting is an important part of this process.

Even if no general CSR reporting enhancement is introduced, some narrower and more specific instances of CSR disclosure and reporting are justified, especially in the interest of transparency. These specific instances include: marked corporate departures from existing strategy and towards CSR; justification of public CSR-related claims; CSR disclosure and reporting that is relevant to investment decisions (including a corporation's orientation towards CSR or not); and individual CSR performance benchmarked against average industry-relative CSR performance areas and levels.

If no CSR reform of the right and moderate kinds emerges from this and the parallel PJCCFS inquiry, this will be a missed opportunity for Australia to become a world leader in developing cooperative best practice on CSR between governments, regulators, business, and communities.

CAMAC's Brief

Caution or Inaction?

As parliamentary comments on the UK's 2005 Company Law Reform Bill reveal, business profitability and socially responsible business behaviour are now almost universally embraced 'as two sides of the same coin' of corporate responsibility and governance.[6] At the same time that 'shareholder value' is often being defined in terms of the accountability of directors and managers to shareholders, a wider conception of shareholder and non-shareholder values and their bearing upon corporate success is also evolving nationally and internationally. CAMAC should not act precipitously in light of this development, but it should not let Australian corporate law stand still in the face of this development either. Exercising caution as CSR developments and standards continue to evolve is not the same as taking no action at all to keep pace.

Translating Terms of Reference into Distinct Areas of Concern

Arguably, CAMAC's brief requires it to focus in the end upon five distinct areas of concern and possible reform:

(1) legislative clarification of the entitlement of directors to take account of relevant non-shareholder interests;
(2) legislative change to the law of directors' duties to require directors to take account of relevant non-shareholder interests;
(3) regulatory means of stimulating and facilitating connections being made between corporate strategy, corporate risk and opportunity management, and socio-economic, ethical, and environmental concerns;
(4) enhancement of meaningful social/CSR reporting; and
(5) governmental CSR policy facilitation and frameworks.

Questions for CAMAC's Attention on Directors' Entitlement or Obligation to Consider

If directors *can* consider non-shareholder interests in particular circumstances already, six additional questions arise for CAMAC's attention that are of great policy, legal, and practical significance. Does that entitlement or discretion need legislative clarification, codification, or guidance? Is the exercise of that entitlement or discretion something that is already implicitly covered under the main 'business judgment' defence[7] and correlative provisions in the Corporations Act?[8] If the mere entitlement of directors to factor non-shareholder interests into their reasoning is simply clarified legislatively, does that clarification also need to make sure that the current 'centre of gravity' of directors' duties and applicable 'business judgment' defences is not shifted in a way that courts could use to transform a 'clarification' into a 'change'?[9] Whether any of this needs legislative attention or not, is the corollary that directors already have an obligation to consider non-shareholder interests, even under the existing law, where that is necessary to decide and act in the company's best interests?[10] If so, how is that claim-right enforced (if at all), and by whom,[11] and does it amount to a breach of duty not to take account of non-shareholder interests adequately or at all, when that is necessary to act in the company's best interests?[12] Finally, does the question of any such obligation under the existing law itself need legislative attention? The point of some of these questions is to highlight that there might be issues that need addressing in some way even if there is no change recommended to the law on directors' duties.

Coming to Grips with the True Nature of Shareholder Primacy

All corporate law and policy – both current and remedial – needs to be defensible in terms of a coherent account of corporate responsibility, governance, and success. The theoretical and empirical cases for legitimate forms of CSR raise questions about the adequacy of current Anglo-American corporate regulation in facilitating an integrated and coherent approach to the relationship between corporate decisions and actions, corporate success and sustainability, and a corporation's constituency of shareholder and non-shareholder interests.[13] Those who advocate or defend the narrowest and most exclusive forms of shareholder primacy need to provide an account of corporate governance and responsibility that legitimizes this rationale and its consequences.

If the fundamental rationale offered is to provide the justified reward of a fair return to those who take the risk of investing capital to enable the company to operate, it needs to be explained why this does not also generate some level of accountability to those who also provide significant financial capital for the corporation's operations (such as creditors, banks, and financiers), or to those who invest other forms of capital in the corporation (such as the human capital invested by its employees). Put another way, not all of the key factors supporting shareholder priority apply only to shareholders. For example, others within the corporation's constituency risk an investment of different kinds of capital in the corporation (eg financial, human, intellectual, and social capital). Even if the notions of 'investment' and 'capital' are conceived only in direct financial and economic terms, members of the corporate constituency in addition to shareholders make an investment of a financial kind in the corporation (eg corporate financiers and creditors). If we say that companies are instruments that properly serve only private interests of property, capital, and contract, we still need to justify why one form of contribution to a company's success deserves not only priority but maybe even exclusivity as the focal point of corporate success over other private and public contributions to a company's success.

The answer might be that, on this view of accountability, employees receive a fair return in the form of wages and employee benefits for their particular investment of capital, while shareholders receive a fair return in the form of stock prices and dividends for theirs, and that these returns each match their particular relationship to the corporation. If such an answer is justified, it is justified by reference to a stakeholder-inclusive rather than a shareholder-exclusive account of accountability, which is matched to the essential relationship between a corporation, its success, and its corporate constituency. Alternatively, if the fundamental rationale offered is to promote accountability to those who are said to 'own' the corporation in some sense, it needs to be shown why this selective isolation of one set of contributors to the corporation's success is justified, and why 'ownership' is the correct characterization of a shareholder's stake in a corporation.[14]

Nobody needs to embrace extreme forms of stakeholder pluralism to have legitimate questions about the meaning, scope, and guiding capacity of shareholder primacy. Indeed, non-reflective and unwavering adherence to some form of shareholder primacy, because of its prevalence in conventional Anglo-American corporate thinking, regulation, and practice, can blind us to the need to question whether this model is a comprehensive and coherent account of contemporary corporate responsibility, whether it even delivers to shareholders what it promises, and whether it or something else is the touchstone really guiding directors in practice:[15]

> Like all suggested maximizing requirements, the requirement to maximize profit (or shareholder wealth) must be read subject to constraints. Even the most committed proponents of the shareholder conception concede that compliance with the law is required … Once one accepts legal constraints on the pursuit of profit, as it seems one

> must, the matter is much more complicated. And if legal constraints are admitted, the question then arises of further moral constraints, which complicates matters further.
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> … Indeed, the practicality claims of minimalist pure stockholder theories may be exaggerated. It does not take agency theory to inform us that managers do not necessarily selflessly pursue the profit-maximising interests of shareholders. They may be more concerned with the long-term development of the corporation as against short-term profits; less laudably, they may be concerned with empire-building, and feathering their own nests. The monitoring costs of keeping a corporation to the straight and narrow road of profit-maximisation may be considerable. In any case, it is not clear that even if profit-maximisation were the undisputed aim, it would provide clear direction.
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> … Indeed, some go so far as to dismiss the shareholder conception as legal myth. The rough-and-tumble of the stakeholder conception seems to approximate business reality far better. Having to juggle the interests of different stakeholder (as well as non-stakeholder) groups is the corporate managerial reality, a reality which simply does not bear out the legal picture of shareholder dominance, providing no evidence of the viability of the shareholder conception.

These are simply starting questions to frame the delicate balance of competing considerations and arguments with which CAMAC (and the PJCCFS) must grapple. One fundamental problem confronting CAMAC (and the PJCCFS) is that there is not one version of the 'shareholder primacy' model but rather different versions. Some versions of the 'shareholder primacy' model do not advance guidance for directors much beyond urging them to manage the corporation for shareholders, maximize shareholder wealth, and enhance shareholder value, as if these mantras contain complete self-executing guidance for decision-making. Some versions do not match the reality of what directors do when they assess risks and decide strategy by reference to how a balance of shareholder and non-shareholder concerns contribute to a corporation's success. Some versions of it frame the relationship between shareholder and non-shareholder interests as one in which those interests simply count as interests in their own right, with non-shareholder interests always being subordinate to shareholder interests, because the corporation's interests are equated for most purposes with its shareholders' interests. This version can be contrasted with other versions in which shareholder and non-shareholder interests relate to each other in terms of their membership of one corporate constituency as well as their relationship and contribution to the corporation's success. Other versions of the 'shareholder primacy' model are possible too.

So, even if CAMAC (and the PJCCFS) largely recommend keeping in place Australian corporate law's current 'shareholder primacy' orientation, perhaps with minor clarifications and changes for directors' duties and CSR reporting, that still leaves the task of identifying which version of that model is being endorsed. Is it one in which directors can consider non-shareholder interests, but only to the extent that they derive from and relate to shareholder interests at any point in time, because corporations are run exclusively for shareholders, for example, or one in which directors must consider non-shareholder interests, because that is part of what an integrated approach to successful corporate strategy and risk management requires, by directors whose fundamental obligation is to the corporation, its multi-faceted corporate constituency, and its ongoing success as a profitable, beneficial, and sustainable business enterprise?

Of course, CAMAC (and the PJCCFS) also have to deal meaningfully with submissions that reject all forms of the 'shareholder primacy' model as incoherent, incomplete, unreflective of reality, unjust, socially harmful, or incapable of accommodating the emerging needs of global trade and economic justice, CSR developments internationally, and the multiplicity of Anglo-American, European, and other approaches to regulating corporate responsibility and governance. Many such arguments view corporate law as being in need of radical restructuring at its core, because of its fundamental weaknesses on any one of the dimensions outlined above, eg:[16]

> Externally, corporations must move from being the private domain of shareholders to being responsible to the democratic order … Internally, corporations must shift from exclusive governance by shareholders to joint governance by employees and shareholders … In the long run, it won't be enough to rely on voluntary initiatives, toothless codes of conduct, enlightened leadership, or reforms that proceed company by company. We must ultimately change the fundamental governing framework for all corporations in law … The belief seems to be that if we put managers through ethics courses, write voluntary codes, teach environmental stewardship, and encourage stakeholder management, we can somehow counteract the overwhelming legal and structural power of shareholders. But we can't.
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> …
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> When a problem is supported by or caused by law, the solution must be in the law. Today, shareholder primacy is in our law. Certainly it's the law as seen by the Delaware courts, which control most major corporations. And in any state – even those with stakeholder laws – directors who fail to maximize shareholder value can be sued. CEOs who fail to do so can be fired. The company itself can be subject to hostile takeover. These are legal mechanisms that hold shareholder primacy in place. And legal mechanisms can only be counteracted by other legal mechanisms.

Implications for Options on Directors' Duties

Accordingly, the menu of options in play here might not be reducible simply to a choice between maintaining the status quo on directors' duties, legislatively confirming that directors can consider stakeholder interests, and mandating that requirement by law. Even the latter option is a relatively mild one, compared to what follows. More radical changes to the role of corporations in society and its governance are possible and likely to be advocated in some submissions received by CAMAC, although they are unlikely to find favour with many businesses, governments, or representatives of investors.

The common admission by business and CSR advocates alike that stakeholder sensitivity is an integral part of any successful business strategy is one factor tending to undermine the argument that consideration of non-shareholder interests is really voluntary, discretionary, and non-integral to a director's responsibilities to the company. Giving legal effect to the admission of stakeholder sensitivity's centrality in business strategy seems to require that directors *must* take account of relevant non-shareholder interests in fulfilling their corporate obligations, with ancillary concerns about stakeholder liability, standing, and assessment all being addressed legislatively as part of the introduction of this regime.[17] At the same time, there are ways in which such change can be suitably phased in, without rupturing the skeleton of corporate law and practice. All of this still falls far short of the kind of de-centring of shareholder primacy that would accompany a 'root and branch' restructure of corporate law to introduce stakeholder pluralism or a more activist vision of the contribution that business could make to social responsibility and governance.

Scrutinising the Proper Reach and Boundaries of Claims

CAMAC is likely to receive a number of submissions putting a side of the debate relevant to the constituent interest group for each submission. In the end, many of these competing submissions will need to be compared and evaluated in terms of the proper reach of their claims.

If we accept that the pursuit of profit is not absolute but is limited and controlled by some legal and other constraints, for example, we need to ground those constraints in an overall account of corporate responsibility. If we argue that socially and environmentally necessary limits on companies should be imposed legislatively through specific statutes with that form of protection as its focus, and that directors should have absolute discretion but no obligations in taking non-shareholder interests into account, both of these prongs must also be justifiable under a complete and coherent account of corporate responsibility.

If we believe – as many business leaders profess – that directors of successful companies must take account of both shareholder and non-shareholder interests in their decisions and actions, we similarly need the regulatory framework to provide adequate support and guidance for that. If we say that corporate law's obligations should be confined to obligations with shareholders chiefly in mind, we still need to justify why consideration and advancement of non-shareholder interests is external to core corporate obligations and not integral to them, especially in light of the prevalence of business claims that business success requires taking account of non-shareholder interests in some way. In other words, if we accept that non-shareholder interests can and do bear upon corporate success, we need to justify why reference to them by directors should only be legally permissive and discretionary, rather than an essential part of the role of running a successful company.[18] None of this means, of course, that *all* stakeholders have an equal claim internally upon a company in terms of standing, governance, representation, voting, and benefits, as we still need to distinguish between those stakeholders 'whose interests should be protected as part of the larger, external democratic polity' and those stakeholders deserving 'an internal voice in governance and a share in profits'.[19]

If we claim that no CSR reform is required, we need to justify why the present status quo of a shareholder-centric model, in which non-shareholder interests are relevant only to the extent that they promote and maximize[20] shareholder interests, is better than any alternative. In particular, we need to justify why this is better than an account of corporate responsibility in which shareholder and non-shareholder interests both have relevance through and because of their relationship to a company and its success, defined in a way that fully meets the economic, social, and regulatory goals enshrined in corporate regulation and law. If we claim that a company's only obligation is to act according to law, we still need to explain what else beyond compliance with the minimum standards prescribed by law is necessary to achieve corporate success, as well as account for the prevalence of companies feeling obliged to take notice of other standard-setting norms and regulation, such as those of business ethics, industry custom, and 'best practice' standards.

If we say that companies and their directors cannot owe obligations directly to non-shareholders, we still need to justify that no other kind of consideration of their interests is necessary either. If we claim that there is no credible alternative to formulating directors' duties to the company in ways that remain silent about reference to non-shareholder interests, we need to account for how and why this model is superior to current UK proposals to mandate consideration of relevant non-shareholder interests by directors, US-style constituency statutes that direct attention to relevant non-shareholder interests, and models that accommodate what the current state of CSR's evolution worldwide means for corporate decision-making, at least for transnational corporations ('TNCs').

If we claim that the success of a company is coextensive with maximizing shareholder wealth, we still need to justify that this model satisfactorily explains everything about a successful company, and equitably aligns what contributes to that success with the fruits of that success. Put more bluntly, 'why, quite simply, aim to maximize profits as opposed to providing a reasonable return on capital, for instance, "the payment of returns to shareholders and investors sufficient to remunerate past investment and encourage future investment in the company"'.[21]

Conversely, if we claim that directors should owe obligations to non-shareholders in addition to shareholders, we still need to justify the purpose, nature, and reach of those obligations, as well as dissipate fears that such reform will only lead to intractable balancing demands for directors, and inevitable erosion of shareholder protection, with no commensurate gain for non-shareholder interests.[22] If we think that only reform of business regulation is needed to enhance CSR, we need to justify how and why that can happen without an overarching governmental policy framework for CSR, akin to that developed in the UK and increasingly permeating policy development in the European Union too. If we argue that shareholder primacy is the wrong orientation for corporate law and that corporate law needs to be reformed at its core, we need to confront the considerable body of legal, economic, and business knowledge and experience opposed to such a radical reform of corporate law, as well as demonstrate that such radical reform will produce more benefits and fewer costs – a daunting task, and one that is unlikely to be viewed by politicians, regulators, and business as a desirable or even viable option, at least at this stage.

From Orientation and Theory to Regulation and Policy

One way towards reform of business policy, law, and practice that is properly more stakeholder-sensitive is to work with and through the models and rationales attached to the prevailing ‘shareholder primacy’ notion, while exposing the incompleteness, selectivity, and inadequacy of those models and rationales where needed. After all, this is a classic area of law where underlying value-assumptions and ideological positions about corporations and their relationships to shareholders and non-shareholders drive everything. The historical, socio-economic, and legal contexts that shaped the evolution of business policy, law, and practice to make particular versions of the ‘shareholder primacy’ notion so prevalent match some but not all aspects of contemporary business responsibility and governance, and frame those aspects in a particular way.

The coherence, completeness, and force of an exclusively shareholder-centred view of the corporation all seem more solid in the context of a factory-owning corporation with all of its employees in a local community and with much of the investment and residual risk in the corporation being undertaken by the small number of original investors who create and manage the company, for example, than they do in the context, say, of a transnational knowledge-based corporation whose business is founded on the intellectual capital of its employees and that derives significant financial capital from sources that are not limited to investors who trade their shares in that corporation in shorter average timeframes than the average length of service of the corporation’s employees. The context of an idea’s or norm’s development shapes that development but neither exhausts nor solely determines its proper content or orientation. The dominance of particular shareholder-centred notions in law and practice is a huge but not insurmountable obstacle to richer or even different notions that include what is valuable about the right kind of shareholder-centred notions, but are not limited to them and hence account better for the full complexity of corporations and their corporate constituencies.

In the example of the factory-owning and knowledge-based corporations above, the scale and cogency of the residual risk being borne by investors is different in each case too. This is an important feature that goes to the accuracy and effectiveness of the regulatory model applying to both examples. Residual risk is one of the key justifications for certain kinds of ‘shareholder primacy’ models. On any shareholder-orientated view, the justification for a particular conception of shareholder priority in directors’ minds and deeds stems from a limited set of key factors, including delegation, investment risk, investment return, capital lock-in,[23] ultimate control, and accountability effectiveness. For example, corporate law provides particular mechanisms of control to shareholders that are not available to non-shareholders (eg AGMs, shareholder approval and ratification, shareholder derivative actions etc), as well as particular accountability mechanisms that provide the most effective way of ensuring that directors facing hostile takeovers act in the company’s best interests and not in ways that preserve their own positions as directors.

However, this does not render non-shareholder interests meaningless, irrelevant, or even of lesser importance in the corporate scheme of things. Nor does it automatically endorse a form of shareholder primacy in which non-shareholder interests are only relevant as derivative interests. Nor does it justify non-responsibility for taking meaningful account of non-shareholder interests that bear upon the corporation's interests and success, however we choose to define them and whatever societal and regulatory policy goals we choose to enshrine within them.

One weakness of the law-focused (especially duty-focused) emphasis in some of the Terms of Reference is that the complex nature of modern regulation and its various forms and effects requires a correlation between a chosen method of regulation and the desirable policy outcome.[24] This also explains why framing debate and regulation around two polar extremes, with prescription of minimum legal requirements by law, at one end, and leaving everything else that is CSR-related as a voluntary and discretionary thing, at the other, does not meet the realities of the different types and effects of regulation today. Mandatory changes to directors' duties, for example, focus on law-based regulation and achieve different regulatory outcomes from cooperative development of stakeholder-sensitive standard-setting through bodies like the Australian Stock Exchange Corporate Governance Council ('ASX CGC'), which in turn has a different focus and set of outcomes from other forms of regulation like accepted norms of business ethics. Similarly, the desirable impact and remedies offered by reform of directors' duties differ from what might be offered by a UK-style Operating and Financial Review ('OFR').

A Suggested Public Process From Here

The CAMAC Discussion Paper offers a comprehensive canvassing of different points of view on CSR, as well as a useful framing of key issues. It does not purport to outline specific law reform changes or to take a position on various debates. All of that is to come, informed by public submissions. If not already planned, I suggest a process from here as follows. The next publication should be a preliminary report that does the following things. First, it should provide a summary and analysis of the submissions and CAMAC's own further consideration of the topic. Secondly, it should outline a series of broad policy positions that encapsulate as much of the common ground as possible, without becoming simply the lowest common denominator of all submissions. Thirdly, it should outline the policy options that are available and their respective strengths and weaknesses. Where possible, CAMAC should prioritise its preliminary preferences concerning those options. Fourthly, it should outline the specific reforms or combination of reforms, in draft terms, that would give effect to each policy option, or at least the policy option(s) favoured by CAMAC. Fifthly, to enable CAMAC's final recommendation to the Federal Government to be informed as specifically as possible by reactions from the academic, business, professional, and community sectors to any specific law reform proposals, the preliminary report should call for submissions on its preliminary conclusions and recommendations, or otherwise facilitate public exposure of the recommendations and feedback on them. As a final step in this process, all of this should be gathered and analysed, leading to a final report with specific final recommendations to government on any changes to CSR law and policy. My suggestions for desirable reforms to include in this package of recommendations appear at the end of this submission.

Interactions with Other Aspects of Corporate Law

Any clarification or reform of directors' duties recommended by CAMAC (or the PJCCFS) needs to take account of any flow-on impact of those recommendations upon other areas of corporate law that interact with the law on directors' duties. If directors are allowed or obliged to do more than what they do currently, that affects the content of directors' duties and reporting obligations. That content not only relates to ASIC's enforcement domain and the basis on which ASIC investigates and acts. It is relevant in other areas of corporate law too, such as 'business judgment' defences,[25] outsider assumptions about compliance with directors' duties in corporate contracting,[26] judicial relief of directors from liability,[27] and other areas where the judgments of directors, the range of things considered by them, and the company's best interests are all in question (eg shareholder derivative actions).[28] In other words, any changes to existing corporate law must be worked through in terms of their potential impact elsewhere in corporate law, especially under the Corporations Act.

Other Australian Governmental Reactions to CSR Initiatives

Other governmental and regulatory initiatives are also in play. CSR and 'triple bottom line' ('TBL') reporting also relate to principles in the ASX CGC's *Principles of Good Corporate Governance and Best Practice Recommendations* ('ASX CGC principles and recommendations'). ASX Listing Rule requirements bolster these standards, under the prevailing 'comply or explain' (or 'if not, why not?') approach. For example, Principle 10 says: 'Recognise the legitimate interests of stakeholders'.[29] It includes but is not limited to developing codes of conduct that recognize legal and other regulatory obligations towards stakeholders, including employees, customers, and the communities in which businesses operate. Recently, as reported in CAMAC's Discussion Paper, the Government has asked the ASX CGC to consider incorporating guidelines for sustainability reporting within these principles. This trend should be continued and amplified. As recommended at the end of this submission, there is much good work yet to be done in cooperatively developing the ASX CGC principles and recommendations in more CSR-sensitive directions, with a view to providing decision-making and reporting frameworks and guidelines for corporations and their directors.

Having two parallel inquiries at the federal level investigating CSR reform does not automatically mean that the Federal Government is predisposed in favour of such reform. Indeed, the Government made its stance on CSR clear in its official response late last year to the proposed *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, developed by the Sub-Commission on the Promotion and Protection of Human Rights within the UN Commission on Human Rights. Writing in the context of international legal responsibility for human rights standards, the Australian Government's formal response made these revealing comments:

> The Australian Government is strongly committed to the principle that guidelines for Corporate Social Responsibility (CSR) should be voluntary. The Norms represent a major

> shift away from voluntary adherence. The need for such a shift has not been demonstrated … We believe the way to ensure a greater business contribution to social progress is not through more norms and prescriptive regulations, but through encouraging awareness of societal values and concerns through voluntary initiatives.

Unless the Federal Government changes this stated position on CSR, or takes a radically different tack domestically from its position internationally, drastic CSR reform is unlikely. Of course, none of that means that minor reforms to make corporate boards consider and avoid unduly harming stakeholder interests, and to enhance CSR reporting and standard-setting, are completely off the agenda. Indeed, one business commentator believes that it is 'likely that the outcomes of the inquiries will be an exhortation to corporate managers to take greater account of social and community concerns and perhaps that reporting requirements for TBL and CSR should be standardised'.[30]

Stakeholder Representation on Boards

Whatever intrinsic importance non-shareholder representation on corporate boards might possess, it is treated as a side issue here, for three reasons. First, adding a stakeholder-regarding gloss to directors' duties does not alone compel stakeholder board representation too, although it does not render a policy or reform initiative in favour of such representation unsound. Secondly, even those appointed to boards partly because they represent a particular constituency are still generally under an obligation to act and decide according to what is in the best interests of the organisation as a whole. We can create exceptions to that by, for example, legislatively permitting a director to vote in the interests of someone else (eg a parent company), but service to that policy imperative comes at some cost to the coherence of the overriding imperative favouring the company's best interests, just as legislatively elevating the interests of some unsecured creditors (eg employees) over others in situations of insolvency because of a worthwhile policy imperative to enhance protection of employee entitlements also detracts from the coherence of the policy position that unsecured creditors are on an equal footing. Policy trade-offs are involved in both situations. Thirdly, to the extent that a stakeholder-regarding focus is or becomes part of what is needed to fulfil a director's duty to the company, all directors need to have that focus and not just those appointed notionally as stakeholder representatives.

The Rise of the Correlation Between CSR, Strategy, and Risk

CAMAC's Terms of Reference expressly mention directors' duties, business practices, and corporate reporting requirements. One important area of business practice that needs alignment with CSR-related aspects is corporate risk management and strategizing that builds adequate account of CSR-related aspects within usual company processes, procedures, and information. Consider the common example of a publicity campaign by a company advising its existing and potential customers that its products are not produced using cheap foreign labour, and meet all major human rights standards. If that public claim turns out to be wrong, it would not only raise questions about the company's liability for misleading or deceptive conduct, but would also call into question the company's own governance of its legal compliance and advertising sign-off procedures, at some cost to the company's reputation. The same could apply to false claims in investment product disclosure statements about taking relevant labour, environmental, or socio-ethical standards into account in investment decisions.

The range of factors driving this need is outlined succinctly in CAMAC's Discussion Paper (pp22-24), in terms worth repeating and highlighting:

> The management of non-financial risks may not necessarily maximize profits or shareholder wealth in the short term. However, failure by a company to identify and properly manage these risks may cause short-term or longer term detriment to the company, such as increased direct or indirect operating costs, regulatory intervention, adverse litigation, harm to corporate reputation or brand image, or reduced employee loyalty or community support. Any adverse outcome may impair a company's business performance and financial position and therefore prejudice its longer term shareholder value. Failure by directors properly to consider, and respond to, these non-financial risks could result in shareholders seeking to replace or discipline them for losing corporate value.[31] Changes in corporate risk profile could also affect directors and officers (D&O) insurance policies.
>
> This form of non-financial risk has been recognized both nationally and internationally, though qualified by the recognition that assessing what constitute material environmental and other societal risks is a more subjective and imprecise exercise than assessing conventional operational and financial risks.[32] Also, the nature of non-financial risks and their impact on operations may change over time [including] health and safety risks, protection of physical assets, regulatory compliance, product liability, brand reputation and protection and asset vulnerability due to greater emphasis on intangibles, changing markets, political, social and economic stability, terrorism and sabotage, human capital, vulnerability of infrastructure, information technology and communication risks and the development and application of new technology.

In this way, CAMAC's Discussion Paper rightly emphasises the increasing significance of CSR-related matters for corporate risk management and strategizing. Increasingly, modern corporate governance realises that maximising profitability, share values, and shareholder returns really requires a multidimensional focus on responding to corporate opportunities and risks from a variety of politico-regulatory, socio-economic, and environmental sources.[33] The only question now is the choice of means to meet this end of better risk management (eg existing or amplified directors' reports, UK-style operating and financial reviews ('OFRs'), risk management standard-setting through ASX CGC principles and recommendations, enhanced social/CSR reporting, etc).

Other commentators reinforce the importance that CAMAC's Discussion Paper rightly places on the relationship between CSR and corporate strategy and risk. Consider, for example, the following diagram from a leading text used in American business schools:[34]

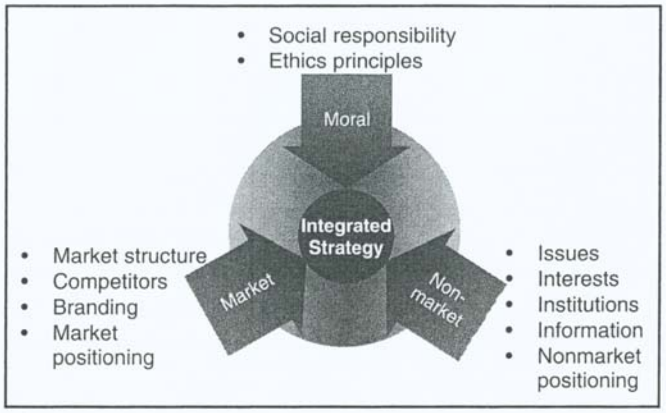


FIGURE 18-1 Integrated Strategy Framework

In this way, at least some forms of CSR-related stakeholder engagement must be built into modern business strategy. Viewed from this perspective, it is inaccurate and incomplete to regard non-shareholder interests as external rather than integral to business strategizing, and to refer to consideration of non-shareholder interests as something that is not only optional and discretionary for directors but which, when it occurs, is totally explainable as something that simply makes non-shareholder interests subordinate to shareholder interests. It makes as much sense as saying that acting in accordance with accepted standards of business ethics is correctly characterized as something that is optional for directors or else simply a 'side-constraint'[35] upon them, rather than something that is integral to what they do.

Some submissions and arguments that favour consideration of non-shareholder interests as something that remains within the discretion of directors are more likely to be most concerned instead about maximizing the decision-making freedom of directors and minimizing their potential exposure to liability. This is compatible with the point being made here about the integral connection between CSR and strategy. At the same time, it points the way towards the eventual need for consideration of non-shareholder interests to be seen as a vital and integral component of business strategizing and decision-making, and hence something that directors must do in fulfilling their corporate duties. Any valid concerns about upsetting the balance of decision-making freedom for directors, increasing their possible exposure to liability, complicating their decision-making responsibility, or diluting shareholder protection can be addressed and ameliorated in other ways. Handled in the right ways, such things are not insurmountable obstacles to necessary awareness-raising and reform in this area.

All Stakeholder Consideration is Not the Same

The legitimacy of core aspects of CSR requires justifying an adequate connection between corporate affairs and social responsibility. Business corporations have no special interest or inherent social role in setting themselves up as alternative policy-makers and social engineers to governments. Being a socially responsible business does not equate to an open-ended and government-like role in promoting economic and social justice and prosperity.

How and why you consider stakeholder interests turns on whether you are a law-maker, policy-setter, social justice group, or business corporation. The point and method of consideration is different in each case. An admittedly imperfect analogy might be made with the consideration of policy interests by different arms of government. Putting aside the special sense of 'policy' in which some commentators argue that judges do not and should not make policy decisions,[36] it is clear that both legislatures and courts consider policy considerations of some kind in their different roles. Yet the point, range, and method of such consideration differs in each case. The way in which we reason about policy, the role of policy considerations in decision-making, and the nature and scope of policy factors considered all vary according to whether we are performing a legislative, judicial, or even executive role. Similarly, how and why government policy-makers consider stakeholder interests, and who are included as stakeholders for that purpose, are all functionally and methodologically different from how and why business corporations consider stakeholder interests. There is no 'one size fits all' approach to stakeholder-sensitive decision-making spanning all contexts.

Moreover, claiming that business corporations must consider and promote non-shareholder interests where that is necessary for a company's success is very different from claiming that business corporations must consider and promote non-shareholder interests at large and for their own sake beyond their relationship to corporate success. Indeed, whatever the problems in conceptualizing and operationalizing it, something akin to this distinction provides the boundary markers between that part of social responsibility that is properly the province of business, on one hand, and that part of social responsibility that is properly the province of others, at least in terms of the focus of corporate regulation.

Current Legal Position

CSR Already Embedded to Some Degree in Australian Corporate Law

The late M. Scott Peck started two of his best-selling works, *The Road Less Travelled* and *Further Along the Road Less Travelled*, with the respective opening sentences, 'Life is difficult' and 'Life is complex'. He might as well have been writing about corporate law, governance, and responsibility. As primary corporate decision-makers, directors habitually engage in information-analysis, interest-balancing, and judgment calls for which mantras about maximizing/enhancing shareholder wealth/value, on one hand, and fairly balancing shareholder and stakeholder interests, on the other, are crude and incomplete proxies for the full complexity of what directors do.

Whatever CAMAC recommends about sensitising the law on directors' duties to CSR, those recommendations occur within an Australian landscape for corporate law that already contains some CSR-sensitive elements. Directors are already required in their annual reports to explain corporate environmental compliance with the law (ie

Corporations Act, s299(1)(f)); and investment product-disclosure statements must reveal the extent to which socio-ethical factors, such as ethical, labour and human rights concerns, affect investment decisions concerning investment products (ie Corporations Act s1013D(1)).[37] So, some CSR aspects are already embedded in Australian corporate law.

Current Australian Law Allows Directors to Consider Stakeholder Interests

The argument is commonly and probably rightly made by business, company lawyers, and corporate scholars that current Australian law on directors' duties implicitly permits directors to consider non-shareholder interests, where doing so relates to the company's interests and benefit. As one of Australia's leading corporate law academics, Professor Ian Ramsay, concludes:[38]

> (T)he argument has been made that the existing law does not allow directors to consider the interests of stakeholders other than shareholders. I suggest this isn't correct. Directors must act in the best interests of the company and this typically means the shareholders.
>
> However, this doesn't mean that directors cannot consider the interests of other stakeholders.

Note that this is an entitlement of directors under the current law to consider non-shareholder interests, as part of deciding and acting in the best interests of the corporation, to the extent that the non-shareholder interests relate to the corporation's interests.[39] This is an important qualification. Directors have no entitlement or obligation under the existing law of directors' duties to consider and give effect to non-shareholder interests for their own sake.

This position has both costs and benefits for business. On the 'benefit' side, it leads to the additional business argument that no significant CSR-related reform of directors' duties is needed, because the law of directors' duties already provides adequate capacity for consideration of non-shareholder interests where necessary. On the 'cost' side, if directors are implicitly allowed to take account of non-shareholder interests as part of what they do in fulfilling their statutory directors' duties, directors are exposed if decision-making that involves consideration of those interests is not already implicitly covered by an applicable 'business judgment' defence.[40] This also raises questions about who (if anyone) might properly complain about inadequate consideration of stakeholder interests, and what kind of consideration of stakeholder interests is due consideration for the purpose of both statutory duties and relevant defences. Moreover, even if existing law on the legal duties of directors already permits reference to stakeholder interests, though not at the expense of shareholder interests, that still leaves questions about how and when that is accommodated within corporate decision-making and reporting frameworks and processes.

CAMAC Should Reject the Option of Creating Substantive Duties to Stakeholders

Of course, creating or clarifying a legal entitlement for directors to consider stakeholder interests in making socially responsible corporate decisions is different from legally requiring directors to take those non-shareholder interests into account in making decisions about the corporation's best interests. This is different again from mandating a legal obligation owed by directors to anyone or anything beyond the corporation as an enterprise. These three different options – discretionary consideration, mandated obligation, and extended duty – are the basic options on directors' duties facing CAMAC (and the PJCCFS) now, just as they were the options facing the earlier Senate Standing Committee on Legal and Constitutional Affairs ('Senate Committee') in its 1989 report, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*.[41] However, the CSR context has evolved and shifted since then, domestically and internationally. The question is: has it evolved and shifted enough to require different answers now?

Whatever other changes might be necessary to corporate law at some point, including at its core, simply expanding the net cast by directors' duties so that directors owe obligations to act in the interests of non-shareholders as well as shareholders is neither the first nor the best step forward. As Professor Ian Ramsay argues:[42]

> A powerful argument in favour of the existing law is that it does provide for an effective review of the actions of directors. If the law were changed so that directors had direct duties to a broad range of stakeholders, the irony is that this may result in directors being less accountable.

In the pithy conclusion of corporate governance theorist and World Bank economist, David Ellerman, '(o)ne sometimes has the suspicion that "stakeholder" governance ideas are being floated by managers who know that, by being responsible to everyone, they will be accountable to no one'.[43] The argument that non-shareholder interests are too diffuse to make a duty to advance non-shareholder interests coherent and workable, especially in resolving any conflicts between shareholder and non-shareholder interests, is a strong but not totally unanswerable one. Some sub-groups of shareholder interests conflict too. True, shareholders have a commonality of interests *as shareholders* that is lacking between other stakeholders. However, it is more conceptually accurate and operationally realistic to frame the decision-making task for directors as one in which choices in the company's interests must be made between competing shareholder interests (eg majority v minority shareholders, present v future shareholders etc), competing non-shareholder interests (eg employees v creditors), and competing shareholder and non-shareholder interests. Nevertheless, binding directors to advance the substantive interests of non-shareholders in addition to those of shareholders, at least under pain of liability for breaching such a duty, is too large a leap for the current law. The stakeholder concerns that are worthy of protection here as a matter of policy should not be cast within such an expansive 'duty' framework. At present anyway, that is simply the wrong regulatory tool for achieving the right policy outcome.

Accordingly, CAMAC and the PJCCFS should reject the option of enlarging directors' duties to include a duty to non-shareholders to advance their interests. That leaves the other two options for consideration – namely, the ‘discretionary consideration’ and ‘mandated obligation’ options.

The Impetus and Directions of Reform

Some corporate law experts suggest that stakeholder-focused concerns are best managed within our evolving corporate governance regime and practice, and not by dramatic changes to the law on directors’ duties.[44] Others point to the advantage of enhancing the trend towards CSR reporting and disclosure over any changes to the law that ‘allow or require directors to prioritise non-shareholder interests over the interests of shareholders’.[45] Some submissions to the parallel PJCCFS inquiry mention the core concern of enhancing consideration by corporate decision-makers of potential adverse consequences of their decisions for various constituencies affected by them, akin to the proposed UK model. I have detailed elsewhere some of the main arguments for and against some reforms, and potential flow-on implications for other areas of corporate law and enforcement, as well as my own preference for a multi-pronged approach attacking this problem on a number of fronts at once, without crippling either business or civil society. Certainly, whatever the outcome of these inquiries, much more can be done in finding ways of incorporating CSR concerns within ordinary business, investment, and rating practices and standard-setting.

The chairman of the James Hardie Board, Meredith Hellicar, stated publicly in March 2005 that, by establishing James Hardie’s compensation fund for asbestos victims in 2001, its directors ‘believed we had achieved the goal of fulfilling our duties as directors to current and future stakeholders, both legally and in the context of corporate social responsibility, by separating our asbestos liabilities from the balance sheet to enhance our attraction to foreign capital markets to fund future international growth, and by meeting our responsibilities by providing for future asbestos claimants’.[46] Hellicar advocated the need for clarity in this area of law to provide directors with a ‘business judgment’ safeguard against potential liability for making socially responsible decisions that accommodate the interests of shareholders and other stakeholders.

At a wider level, this is one reason why some commentators suggest that directors might even benefit from legislative clarification of their need to consider shareholder interests, to assist them in meeting the expectations, if not the claims, of disgruntled shareholders. This would be on the basis that legislative permission or even direction to consider relevant non-shareholder interests would ‘shield’ directors from both shareholder and regulatory action.[47] In other words, directors might take some comfort in being able to point expressly to something in the law that relates to non-shareholder interests to explain and justify their decisions if need be to investors, the market, and regulators.

There is emerging acceptance across the public, private, and community sectors, both nationally and internationally, that the ways in which corporations choose to act in the interests of their shareholders should not be at the expense of causing undue adverse consequences for non-shareholders and society at large. The trouble is that there is much disagreement about the following: how corporate activities are conditioned or constrained in this way; what makes an adverse consequence for non-shareholders ‘undue’, or unjustified, and hence impermissible in terms of business ethics and law; and how any of this is best regulated.

You can be an advocate of corporate social responsibility and still want legislators to choose carefully from the menu of CSR-options confronting them in inquiry submissions and the academic literature. It is not anti-business to advocate a rethinking of corporate obligations and directors duties’ so that both are more sensitive to the interplay between shareholder and stakeholder interests.

Still, we should not change directors’ duties too much without first challenging regulators and business to develop better operational and decision-making guidelines that reflect a change in thinking and behaviour, starting with amplification of the ASX CGC principles and recommendations, to enhance corporate decision-making and reporting in terms of the interdependence of shareholder and stakeholder interests, and to apply this to ordinary corporate strategizing, risk assessment, decision-making, and reporting.

Almost everyone agrees that corporations need to be mindful of those who are or could be affected adversely by their actions. People might disagree about the circumstances in which that happens, and about what it means in terms of legal duties. Yet there is little disagreement about what might be termed the ‘principle of responsibility’. Corporations and their officials must wield power responsibly. That imperative conditions the exercise of that power and, in that sense, is integral to it. The content of that responsibility has both positive and negative aspects. Corporations and their officials must satisfy the needs of the shareholding part of their corporate constituency in ways that do not exploit others unconscientiously. US President Bill Clinton’s former national economic advisor, Gene Sperling, describes it in terms of a ‘discretionary principle’ embodying a ‘“last resort” ethic’:[48]

> We should expect our CEOs to follow an ethic of corporate responsibility, including what I would call the ‘discretionary principle’, meaning that when CEOs choose among a range of options for achieving efficiency and competitiveness, they should exercise every reasonable option that minimizes job loss and community devastation. Exercising the discretionary principle is not about whether a company chooses its workers over its shareholders, or social responsibility over profit. It is about expecting business management faced with ‘gray’ choices and discretion among economically viable options to strive for the path that minimises harm to workers and their communities.

Faced with the downturn in the US airline industry after the September 11 terrorist attacks on New York’s World Trade Centre in 2001, for example, Southwest Airlines reportedly strived to maintain its long-standing record of no employee lay-offs by choosing other cost-reducing options to keep the airline going, including pay cuts for its executives, with the result that Southwest Airlines became the only US airline to report a profit in the year following September 11, as Sperling explains.[49] This can also be viewed as an example of socially and ethically sensitive considerations conditioning the exercise of business decision-making and informing the selection of business choices between different ways of conducting business. None of this can be characterized crudely in terms of a simple zero-sum competition between shareholder interests, on one hand, and employee and other stakeholder interests, on the other.

For good legal, ethical, and social reasons, corporations must comply with the law, even when doing so costs rather than benefits the corporation and its shareholders.[50] So, corporations and those who decide and act for them are obliged to meet CSR-related obligations already enshrined in environmental, employment, and other laws. The content and reform of those laws is responsive to societal needs and changes, which inform legislative clarification and amendment as well as judicial interpretation of the law.[51] As Professor Ian Ramsay notes about the role of judges in sensitizing the law of directors duties to community concerns, ‘Australian courts have successfully applied directors’ duties to different circumstances and adapted the law where appropriate (for example, gradually increasing the standard of care and diligence expected of directors as community expectations have increased)’.[52] So, the current policy debate about CSR is relevant not only for any reform of corporate law but also for existing judicial interpretation and community standard-setting for statutory directors’ duties and their equivalent duties under the general law, even if the current Australian CSR inquiries recommend no change to the statutory law.

Australian corporate regulation and practice is probably not yet ready for a corporate dynamic that does not have shareholder-centeredness at its core. At the same time, accountability to shareholders does not mean that shareholder interests automatically preclude other interests. It does not mean that corporate unlawfulness or irresponsibility becomes justified in the name of shareholder primacy. It does not mean that there are no regulatory constraints upon corporations other than those embedded in corporate law. It does not mean that the business corporation’s ongoing success and future shareholder interests, along with all non-shareholder interests, are all sacrificial lambs at the altar of worshipping immediate full-scale maximization of wealth at all costs for whoever happen to be shareholders currently. This is not because of any relative assessment of the weight of shareholder and non-shareholder interests in moral or political terms, but because of the different dynamics in the relationship of each to the corporation and its success.

In its PJCCFS submission, the Australian Institute of Company Directors (‘AICD’) concludes:

> The Corporations Act does not hinder Australian companies or directors from taking into account the interests of all stakeholders in a way that is necessary to ensure that a company is successful and sustainable … More than most phrases, ‘corporate social responsibility’ (CSR) means different things to different people. This threshold difficulty of a clear definition makes it inappropriate for mandated behaviour.
>
> For the vast majority of Australian boards, determining the ‘interests of the company’ as a sustainable entity is not a question of trade-offs between competing stakeholder interests. Australian boards generally operate on the basis that to be sustainable, a corporation must maintain a reputation for ethical conduct and accommodate the legitimate interests of shareholders, employees, customers, business partners, the communities affected by their operations and the environment. This approach is necessary to meet both changing societal expectations and the requirements of law.

> …
>
> The Corporations Act should not be amended to impose an additional generalized social responsibility obligation. If … that is required, it should only be permissive.
>
> It would also be inappropriate to mandate further CSR-based reporting obligations.

In particular, the AICD warns against the nightmarish vision of ‘a generalized “social responsibility” obligation’ being additionally imposed upon directors, under which a ‘vague’ and largely indefinable mass of unbalanceable stakeholder interests results in accountability to shareholders being ‘diluted’ and in directors having their essential decision-making ‘compass’ thrown out of kilter.

The AICD Submission’s account of deciding in a company’s interests is not reducible to simple mantras about shareholder primacy. Viewed in the right way, it is consistent with the rich account of corporate responsibility endorsed by this submission. It rightly warns of the risks inherent in mandating forms of CSR that simply endorse stakeholder pluralism. It highlights legitimate concerns that must be addressed in any reforms contrary to its ultimate recommendations against requiring directors to factor non-shareholder interests into their decision-making and against enhancing CSR reporting. As this submission shows, some of its concerns might be approached in other ways, and some of them might even be defused, at least to some degree.

Towards a Coherent Policy Framework on CSR

Global, Regional, and National Dynamics

Notwithstanding the narrowest forms of exclusive shareholder-based models of corporate governance and responsibility, no shareholder or business corporation is truly an island. Notwithstanding the broadest forms of pluralist stakeholder-based models of corporate governance and responsibility, no business corporation is truly an alternative government, charity, or social engineer.

We are at the point in the evolution of the thinking and practice of corporate responsibility and governance worldwide where policy, regulation, and standard-setting for corporations must increasingly be developed from a cross-disciplinary basis, grounded at least in economic, politico-regulatory, and socio-ethical thought and action. Australian corporate law and regulation must serve the domestic needs of international governance, such as solving problems of worldwide concern that require coordinated action by state and non-state actors, and meeting international obligations in the areas of trade, labour, human rights, and the environment. It must serve the needs of national and sub-national governance, such as facilitating the national economy and its constituent elements, and making the Australian economy and business environment internationally attractive and competitive. It must serve the goals of corporate law, which includes rules and doctrines covering the interests of shareholders and non-shareholders, and the interplay between them.

Clearly, a business is not a charity, a business has responsibility to its owners as well as others, a business needs to make money to survive, and the directors of a business corporation cannot have a blank cheque to sacrifice shareholder interests to non-shareholder interests. However, all of that is the start and not the end of a full account of corporate responsibility. Moreover, acting primarily in the interests of shareholders without regard to, or even at the expense of, the interests of other stakeholders, including those who might have contributed something directly to the prosperity of the corporation (such as employees, creditors, and people using the corporation's products), must be justified within a coherent conceptual and regulatory framework of corporate relationships and the responsible exercise of corporate power.

Now that the opportunity for CSR policy-setting has arisen, government policy must take a holistic and contemporary view of corporate responsibility, and cannot engage either in the tunnel vision of confining CSR to matters of directors' duties and reporting requirements, or in the cherry-picking preservation of some favoured benefits (eg limited liability for shareholders) while eschewing other responsibilities (eg obligations to consider non-shareholder interests that are relevant to corporate success). On any account of corporate responsibility, a system of corporate law and regulation is flawed to the extent that it takes full account of everything that benefits shareholders and inadequate account of the costs to others of providing those benefits, or of the interplay between both elements in achieving corporate success. No shareholder-focused theory or model truly requires that.

National and global prosperity and well-being have numerous preconditions, including social, economic, and environmental preconditions. Those preconditions include the platform of underlying social capital and trust upon which all of the rule of law, governance, and economic capital depend.[53] No individual or entity is truly disconnected from this wider context, and all individuals and entities have varying capacities to affect it for better or worse. Legal, political, and moral theory provide the structure and imperatives within which this wider context is connected to societies and to the norms that govern relations within and between societies. In turn, those norms both reflect and shape the responsibility of individuals and other entities, including business corporations.

Whatever the need for 'free' and 'open' markets on some levels, markets also need regulating for different international, governmental, business, and social reasons. For example, fears of political instability, social disharmony, and economic ruin prompted capitalist societies to create social safety nets and welfare systems in the wake of the Great Depression, not least to enhance market support and to compensate those harmed economically by market failures.[54] In the eyes of UN Secretary-General Kofi Annan, the future of the global economy and multilateral trade regime rests on reciprocal guarantees of universal human rights, employment standards, and environmental protection in a new system of global governance in which governments, business, and others all have a part to play, in light of the global economy's vulnerability 'to backlash from all the "isms" of our post-Cold War world: protectionism; populism; nationalism; ethnic chauvinism; fanaticism; and terrorism'.[55] Australia has a stake in all of this, and its regulatory approach in the 21st century must be framed with one eye on its domestic needs and the other on international dynamics and trends. In such an environment, insistence on the crudest and most one-dimensional form of shareholder primacy as the paramount principle in developing appropriate corporate regulatory policy is not the only option.

Connections Between Corporate Constituencies, Responsibility, and Success

However anyone might frame their own account of corporate responsibility, nobody seriously denies that the authority and legitimacy of corporate decisions and actions is a product of the corporation's purpose (ie why the corporation exists), status (ie what it is), capability (ie what it can do), constituency (ie who it concerns and affects), engagement (ie how it relates to its constituency), standards (ie what norms govern and regulate it), and conduct (ie how it behaves and performs). The multivalent nature of each of these things, and the interplay within and between them, makes this complex rather than simple, and certainly something which cannot be encapsulated simply and one-dimensionally in the injunction to do whatever is best for shareholders. Those decisions and actions must be justified in terms of something which relevantly accommodates all of those things in a meaningful and coherent overall account of corporate governance and responsibility. Any account of corporate responsibility that does not do this is a weaker account than one that does.

Stating that corporations are only responsible to their shareholders is not a complete account of corporate responsibility, at least without further explanation of what that accountability really involves. At the same time, pointing to the incompleteness of this account does not automatically mean that corporations have the same responsibility to shareholders and non-shareholders, or that shareholder interests are inappropriately trumped by non-shareholder interests. It simply emphasizes the need for an account of corporate responsibility and governance that can do all of the work required of it, from justifying shareholder returns and the primacy of shareholder interests in the scheme of corporate accountability, on one hand, to justifying the conditions under which non-shareholder interests and even wider concerns deserve consideration and principled treatment in corporate decisions and actions, on the other.

Corporations have particular legal obligations to shareholders, as well as particular legal obligations to people other than shareholders too. In addition, corporations are subject to a wide range of regulatory and non-regulatory norms and standards of behaviour beyond mere compliance with the law. Even admitting that non-shareholder interests are relevant to corporations to the extent that they relate to shareholder interests, and hence might even be taken into account by corporate executives in the course of deciding what would be in the best interests of the corporation and its shareholders, does not exhaust the ways in which those norms and standards of behaviour now require corporations to factor non-shareholder interests into the corporate equation and to treat them in a principled way.

A corporation's executives owe legally enforceable obligations to the corporation as a whole. This means acting in the interests of the corporation as a whole. The interests of the corporation lie in being a sustainable, responsible, and beneficial profit-making enterprise. Each of those dimensions of success has its own distinct strands. To survive and be successful, the corporation must be responsive to its corporate constituency and act in a principled way towards it. That constituency comprises a range of interests who have some kind of relationship to the corporation in its various roles, all of which have in common their own special connection to the corporation and its success. That connection varies according to the nature of each constituent group, the nature of their interests, and their place in the corporation's success.

The corporate constituency includes the corporation's original investors and other shareholders as its primary but not only object of focus in achieving sustainable profitability. The constituency consists of those who invest money in the corporation (ie shareholders), those who finance the corporation (ie banks and financiers), those who govern the corporation (ie directors and managers), those who contribute labour to the corporation (ie employees), those who constitute the market for what the corporation does (ie consumers, customers, or clients), those who have commercial dealings with the corporation (ie distributors, suppliers, contractors, and creditors), those who constitute the communities (however defined) in which the corporation operates, and all others relevantly connected to the corporation and its activities in some way. The nature, scope, and priority of each of those interests turns on their relationship to other interests within the corporate constituency, as members of that constituency, whatever other relevance those interests might have beyond their membership of that corporate constituency. Extracting shareholder interests out of this equation and its surrounding context, and then treating shareholder interests in the abstract as the default substitute generally for the interests of the corporation as a whole, offers an incomplete and incoherent account of corporate responsibility and accountability.

A corporation's multi-layered responsibility to do what is needed to sustain the corporation's profitability, so that it can fulfil its various responsibilities - including provision for the maximum financial returns to shareholders that are possible in light of the corporation's overall responsibilities – is a far cry from a one-dimensional responsibility to give effect to shareholder preferences or demands come what may, or even to do what will maximize financial benefits in the short term for those shareholders for the time being. This is another example of the points at which an abstract and one-dimensional recourse to the shareholders' interests as a default replacement or even working rule of thumb for the corporation's interests breaks down. At certain points, it starts to lose its explanatory force as a total account of corporate governance and responsibility. It also starts to lose its normative force as an overarching guide for executive decision-making.

Viewed in this way, the success of the business corporation turns on the link between the corporation, its constituency, and its responsiveness to those claims. Accordingly, the legitimacy of a constituent interest's claim upon the corporation is a product of multiple factors and falls to be assessed within this framework. Both the law and business practice often translate all of this into a shorthand equation of the corporation's best interests with those of its shareholders a whole. This operates sufficiently in some not but not all situations, because of its incompleteness as an account of corporate responsibility. In reality, deciding what lies in the business corporation's best interests often is a more complex exercise, and one that requires more than exclusive and one-dimensional attention to shareholder interests.

This framework briefly sketched above is the starting point for sound policy development, law reform, and business practice alike. While it will not necessarily fulfil everything sought by each of the various approaches outlined in CAMAC's Discussion Paper - what CAMAC describes as the 'compliance', 'philanthropic', 'commercial', 'ethics-based', and 'altruistic' approaches - it offers a significant point of convergence between all of those approaches.

Making the interests of shareholders exclusively constitute the interests of the company is different from making the company's success as an enterprise the benchmark for deciding the interests of the company. Under that benchmark, shareholders might still have priority or even paramountcy on some dimensions (eg power-exercising dimensions of corporate accountability for AGMs, shareholder ratifications, derivative actions, and anti-takeover vigilance), but both shareholder and non-shareholder interests would be considered by reference to that benchmark.

Of course, there can be argument about the dimensions and criteria of success here – success as an economic enterprise alone or success in other ways too, for example. However, that simply means that debate is then engaged at the right point about viewing the company's interests as a whole, what it means for the company to sustain success as a profitable, beneficial, and responsible enterprise, and how the interests of the company's constituency relate individually and collectively to that success, instead of foreclosing that debate by an advance directive to view the company's success solely or predominately through the prism of one constituent group.

Put another way, and in terms used by a major TNC,[56] sustainable corporate success requires 'the right balance between self-interest and altruism'. Giving such comments substance means defining corporate success completely rather than incompletely, and then aligning corporate success to a company's constituency completely rather than incompletely.

We might need to establish a policy rationale for enhanced corporate consideration of stakeholder interests in terms that cut across some fears and assumptions on both sides of the debate about shareholder and non-shareholder interests 'trumping' one another. The basic proposition is that all members of the corporate constituency have legitimate interests that are entitled to consideration and share in common an equal right to have those interests considered according to their place in the corporate constituency. Here, the equality of interests does not mean that they have to be treated in the same way, as the principle of equality means that like cases are treated the same and unlike cases are treated differently. The places of shareholder and non-shareholder interests in the corporate constituency are not equal in all respects. The nature of shareholder interests, their relationship to the company, and their relative place in the corporate constituency results in directors having an obligation to decide in ways that will benefit and advance shareholder interests. However, as other commentators explain,[57] the equivalent dynamic concerning non-shareholders means that there is no trust-like positive obligation upon directors to advance their interests for their own sake, but still a need to consider them and to avoid causing unjustified harm to them. Again, as others have argued, where the level or risk of potential harm to non-shareholders from corporations is unacceptable socially and environmentally, that might demand specific legislative protection that is harm-sensitive and specific to the relevant area (eg environmental protection), instead of simply requiring that as one component of an enhanced and general directors' duty to consider stakeholder interests. Both might also be needed.

The Gap Between Minimum Legal Obligations and Corporate Success

The whole CSR arena is replete with attempts to set limits between what is mandatory/necessary and what is voluntary/discretionary. The most common distinction is between the minimum obligations upon business that should be mandated by law and what business might voluntarily undertake on some CSR level over and above that. On some dimensions, however, even these limits fall away. CSR policy-making and law-making presupposes a coherent account of corporate responsibility. In politico-ethical terms, those individuals or entities with a special capacity to affect vulnerable interests for better or for worse arguably have an obligation to consider this potential effect upon those interests,[58] just as those with a special capacity to assist in human catastrophes arguably have an obligation to exercise that capacity in appropriate ways.[59] Recent business responses across various industry sectors and national boundaries to the human relief effort needed in the wake of tsunamis, hurricanes, and the AIDS crisis are a testament to this.

Yet the law characteristically imposes only minimum constraints upon harm-causing abuses of power and other exploitation of vulnerable people, in the sense that not all harm-causing acts but only negligent ones are compensable, and that only exploitative contractual relations are interrupted and not just those where there is an inequality of bargaining power. Therefore, a gap commonly exists between the minimum obligations mandated by law and both that dimension of corporate success that requires more than legal compliance and that aspect of politico-ethical responsibility above and beyond the minimum obligations required by law. All of this still leaves the question of the context and content of that bare minimum, which itself is subject to change as power balances shift over time, as evidenced by regulatory changes in favour of consumers, small business, employee interests, and environmental interests.

Only the crudest forms of the 'shareholder primacy' model require blinkered attention to shareholders alone amongst all members of the corporate constituency, to shareholder wealth alone amongst the range of possible shareholder values,[60] and to outcomes for current shareholders alone amongst those shareholders who obtain value from the company as a successful enterprise over the long term. Most realistic 'shareholder primacy' models accommodate necessary limitations on absolute maximization of shareholder financial wealth and other shareholder goals at the expense of all other interests. Debate then shifts to what is 'necessary', whether 'maximisation' is a coherent objective, and whether necessary limits on pursuit of shareholder interests alone can be built into corporate goals or alternatively are best left as external constraints on corporate goals.[61] However, whatever way you slice this cake, it still means confronting a manageable way for corporate directors to assess, accommodate, and decide based upon both shareholder *and* non-shareholder interests, as part of their core corporate obligations.

The Zero-Sum Nature of Shareholder-Stakeholder Conflicts?

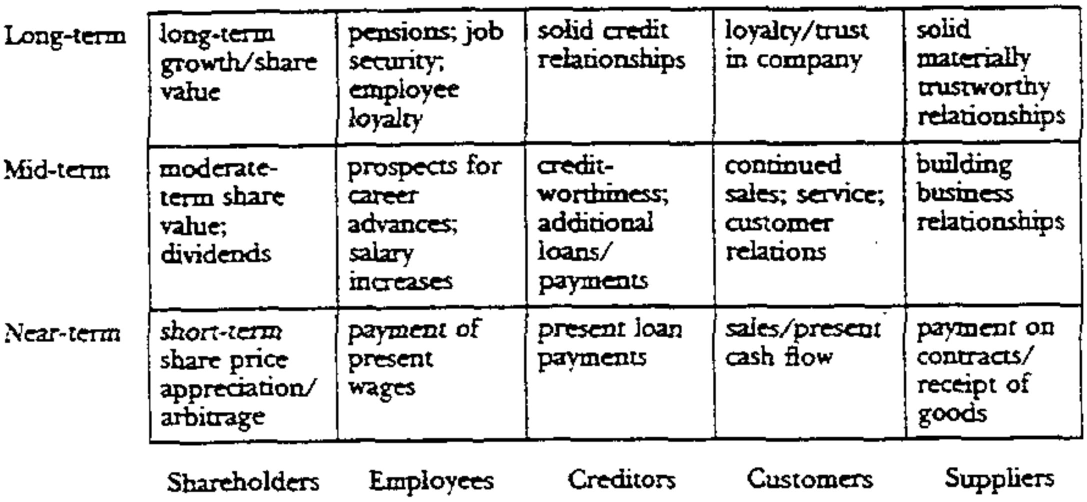
Any valid CSR model must still address the zero-sum problem of shareholder-stakeholder relationships, in which the perception is that one interest can only succeed at the expense of the other. We need to transcend the unproductive focus in much public debate about shareholder and stakeholder interests trumping one another in a zero-sum way. At the same, there clearly are genuine zero-sum situations where shareholder and non-shareholder interests compete in the short-term or over the long-term. However, this should not necessarily be cast in terms of one set of constituent interests absolutely trumping the other. That trumping may wear two different hats at the same time, in terms of how it might be characterized, as outlined in the following example and discussion.

Take the useful example given by Wharton School professor, Eric Orts, one of the leading US writers on corporate constituency statutes. The following passage is quoted in full, as it positions the example within a useful discussion of the weakness of standard 'shareholder primacy' mantras about maximizing wealth, managing for shareholders, and creating shareholder value, at least as explanations that offer any real guidance to directors for the complex interest-assessing and interest-balancing tasks in which they engage:[62]

> The 'paradox' that a corporate decisionmaker may favour nonshareholder interests without impairing shareholder interests is traditionally resolved by referring to the fact that managing an expanding business as a going concern, and distributing profits and other 'benefits' along the way, is not (one hopes) a zero-sum game. Good management aims to satisfy competing, but essential, interests (shareholders, employees, customers, creditors etc) with the goal of expanding the corporate pie. With successful management and an expanding pie, increasing the portions distributed to the various interests allows for the prevailing mystification that the management strategy is primarily *for* shareholders. The fact that an expanding business is not a zero-sum game allows for the sleight-of-hand that rationalizes decisions benefiting nonshareholder interests as being in the 'long-term' interests of shareholders.
>
> At some point in any close analysis of corporate decisionmaking, however, this illusion breaks down. Take, for example, a corporate decision to give certain key employees a significant raise, but to reduce or eliminate dividends paid to shareholders. If this decision is well-calculated to 'grow' the company, then it can at the same time be rationalized under the Delaware law theory as 'rationally-related' or bearing a 'reasonable relationship' to the 'long-term' interests of shareholders. But any decision calculated to increase the corporate pie over a certain time horizon can be rationalized in this way. In the near-term, a trade-off is clearly made, preferring the near-term interests

> of employees to the near-term interests of shareholders, and these sorts of 'horizontal' trade-offs among corporate interests are the stuff of daily corporate decisionmaking.
>
> Professor Ryan recently made the point that: 'At root, the issue is not *whether* corporate managers and directors should consider stakeholder interests in making corporate decisions. Despite occasional rhetoric to the contrary, they must and do consider stakeholder interests constantly as they broker the contributions of corporate participants towards the ultimate goals of survival and success.' … There is also what can be conceived of as a 'vertical' plane of tradeoffs constantly being made between 'short-term' and 'long-term' interests of the corporation and its composite interests … This complicates the picture of corporate management considerably, for all of the tradeoffs among interests in the 'near-term' also may be made in the 'long-term', and different permutations are possible for different combinations of near-term and lomg-term interests of different groups. *See* Figure 1. For example, a decision to benefit the near-term interests of shareholders may adversely affect the long-term interests of employees and vice versa; or the choice may be between the near-term interests of both employees and shareholders, and the long-term interests of both. The basic point is that the simple admonition to manage for shareholders, though perhaps useful in providing some short-hand practical guidance, does not capture the necessary complexity of corporate management and, on closer analysis, amounts to a paradox that only a more complex theory can resolve.

Figure 1. The Complexity of Corporate Decisionmaking



Long-term	long-term growth/share value	pensions; job security; employee loyalty	solid credit relationships	loyalty/trust in company	solid materially trustworthy relationships
Mid-term	moderate-term share value; dividends	prospects for career advances; salary increases	credit-worthiness; additional loans/ payments	continued sales; service; customer relations	building business relationships
Near-term	short-term share price appreciation/ arbitrage	payment of present wages	present loan payments	sales/present cash flow	payment on contracts/ receipt of goods
	Shareholders	Employees	Creditors	Customers	Suppliers

"Horizontal" tradeoffs among various corporate interests (non-exclusive list)

I agree with Orts' 'basic point'. On my favoured conception of corporate responsibility, this fits within an understanding of the relation between a corporation, its multi-dimensional constituency, and its success. It also fits within a conception of the interests of the corporation in which shareholder interests and non-shareholder interests have relevance not simply *as interests*, *in the abstract*, *in their own right*, and simply *relative to each other*, but in terms of that overarching relation. To the extent that particular forms of the 'shareholder primacy' notion have coherence and value, they do so within a wider and richer account of corporate governance, responsibility, and practice that fully accommodates that relation. This is why I do not believe it is accurate to say that a notion such as 'the best interests of the corporation' is inherently meaningless, either in the abstract or unless coupled with an instruction to equate it to the interests of shareholders, whatever the latter means precisely in this context. It is also why, whatever other advantages the UK proposal offers, I do not favour equating these two things, as in the UK proposal. This is not because I view shareholder interests as being of equal or lesser importance to non-shareholder interests, but because of how I frame *the point* of their consideration, and the danger that an express equation of corporate interests simply with shareholder interests will too easily lead to crude 'shareholder primacy' interpretations and practices that do not match the richer notion of corporate responsibility sketched here. There are some levels – of standing, control, and investment return - on which it makes sense to talk about corporations being run *for* shareholders, and other levels on which it is not adequate simply to talk in terms of a corporation being run *for* any particular group within its corporate constituency.

Noted economist Milton Friedman eloquently makes a different zero-sum argument about CSR with these striking examples:[63]

> What does it mean to say that the corporate executive has a 'social responsibility' in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire 'hard-core' unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty.

Ultimately, however, these arguments misfire or are misdirected. First, shareholder and stakeholder interests are not always bound together in zero-sum terms. A bank that develops new low-cost housing and small business finance packages that give it entry to new sections of the housing and business market, which in turn enables local political leaders to attract families and investment in rebuilding a run-down and poor urban community, expands its business competitiveness and profitability in a way that benefits both its shareholders and local community stakeholders.[64] Another bank that develops a policy of supporting a new and socially beneficial sector might discover that its loan officers become more knowledgeable about that sector and more sure about the bank's position on it, leading to better internal guidleines and more confident lending in that sector. Similarly, as C. K. Prahalad argues in his ground-breaking book on eradicating poverty in the developing world, *The Fortune at the Bottom of the Pyramid*, tackling the poverty of millions of people worldwide presents new market opportunities that can be structured in ways that meet the needs of profitability and human dignity alike.[65]

Second, Friedman's examples are all examples of corporate executives behaving like social engineers and policy-makers at the direct expense of the economic interests of a company and its shareholders. Corporations and their executives do not have to commit business suicide in order to act responsibly. How and why they accommodate shareholder and non-shareholder interests in their decision-making matters, and matters in a way that is different from what governments or charities do when they are socially responsible. The claim that corporate power must be exercised responsibly is not a claim that transforms corporate executives into policy-makers or social engineers. Of course, some of CSR's forms at the extremes might urge such roles, but that simply points to the need for clarity about which form of CSR is under discussion.

In sum: aligning the interests and success of the company with its corporate constituency, as distinct from a particular group (ie shareholders) within that corporate constituency, and then framing the duty of directors as one owed to the company, at least has the advantage of avoiding some of the tired debates in which shareholder and non-shareholder interests are perceived as being in a zero-sum competition with each other, with shareholder primacy meaning that shareholder interests always trump non-shareholder interests, but with scant attention in that simple account to their true relationship to each other, the company, and others. None of this means that there is no sense in which those two sets of interests might ever conflict. What it does mean is that the framing of the conflict and its resolution is not a straight contest between two opposing sets of interests at large. Rather, the lynchpin is the relationship of each constituent group to the success of the company, conceived in terms of the ongoing survival and value of the company as an economically profitable, organizationally responsible, socially beneficial, and environmentally sustainable enterprise.

What Some of the Leading Economic and Corporate Thinkers Say About CSR

'Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible', argued Milton Friedman more than 40 years ago in his landmark book, *Capitalism and Freedom*.[66] Much has been written about these words ever since. Nothing in Friedman's statement means that corporations and their directors can pursue that objective with absolute freedom, unhindered by any legal, ethical, or other constraints. Admittedly, Friedman himself originally conceived of boundaries on profit-making narrowly rather than broadly, in terms of how a corporation 'stays within the rules of the game, which is to say, engages in open competition, without deception or fraud',[67] and not in terms of broader stakeholder-focused concerns grounded in the place of corporations in civil society. Friedman's later formulation of his grand claim in his landmark 1970 *New York Times Magazine* article on this topic expressly contemplated constraints upon business grounded both in law and business ethics, in terms of a corporate executive's responsibility to the corporation's owners 'to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom'.[68]

The American Law Institute's *Principles of Corporate Governance* quoted in CAMAC's Discussion Paper (p 25) also demonstrate that conducting a responsible business requires attention to ethical considerations that apply '(e)ven if corporate profit and shareholder gain are not thereby enhanced'. Nobody seriously suggests in public anymore that business responsibility has no ethical or social dimension. Introducing new corporate reforms in the wake of Enron and WorldCom, US President George W. Bush directly linked the ideas of business, responsibility, and conscience, in a way that expands the accountability of business beyond market demands and corporate self-interest:[69]

> The whole design of free market capitalism depends upon free people acting responsibly. Business people must answer not just to the demands of the market or self-interest, but to the demands of conscience.

By 2005, Friedman was arguing that his statement that 'the social responsibility of business [is] to increase its profits' is equivalent to someone else's statement that 'the enlightened corporation should try to create value for *all* of its constituencies'.[70] All of this shows that the issue of corporate responsibility is complex and not fully captured in one-dimensional clichés about 'shareholder primacy' and 'shareholder value', at one extreme, or embracing the 'triple bottom line', at the other.

If, as even this line of argument from leading authorities suggests, total maximization of corporate benefit and shareholder gain has to give way to other considerations, we need a coherent account of corporate responsibility to accommodate that, just as we need such an account to accommodate the priority that corporate law gives to creditors' interests over immediate shareholder gain upon corporate insolvency. For example, can these things be conceived in ways that are still tied to shareholder primacy, do they count as exceptions to shareholder primacy, or are they part of a wider conception of corporate responsibility that is not fully explicable simply by equating the corporations' interests with its shareholders' interests for all purposes? The answer to that question not only provides the policy justification for maintaining or reforming the existing law. It also points the way towards an accurate conception of the relationship between a corporation, its corporate constituency (comprising shareholders and non-shareholders), and its success. That conception provides the framework within which directors decide and act, and guidelines and standard-setting for that must be developed.

This is one reason why I have pointed elsewhere to the need for these Australian CSR inquiries - and submissions, commentary, and policy-making and law reform concerning them - to ground their analysis and recommendations in a sufficiently developed and articulated conception of corporate responsibility and governance.[71] This is not a claim that everyone suddenly needs to become a corporate philosopher and to find the demonstrably 'right' theory, simply to decide whether to reform this area of corporate law or not. That throws out this jurisprudential point's baby with the bath-water. Rather, the point is simply that, the more that the corporate law jigsaw is maintained or reformed without reference to such an overarching conception, the more risk there is of it causing an undesirable or unintended ripple effect elsewhere, particularly when we already know that the content, scope, and fulfillment of directors' duties has implications elsewhere in corporate law.

In a landmark paper on the modern status of corporate law, Yale University's Professor Henry Hansmann and Harvard University's Professor Reinier Kraakman stated that the end of the 20th century witnessed 'the recent dominance of a shareholder-centred ideology of corporate law among the business, government, and legal elites in key commercial jurisdictions', so much so that '(t)here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value'.[72] Although hotly contested by others, their core claim was about the advantages of what they called the 'standard shareholder-oriented model' over state-oriented, stakeholder-oriented, and manager-oriented models.[73] Yet, as they later explained elsewhere, the desirability of the 'standard shareholder-oriented model' does not translate crudely, simplistically, and one-dimensionally into calls simply to serve the best interests of shareholders alone by, for example, maximizing market share prices and financial returns for shareholders at all costs.[74] Rather, this shareholder-focused model provides the best orientation for those managing a company to follow, if they are to help the corporation to achieve its ends and thereby contribute to society.

The steps in their argument are simple but fundamental. All of those who agree to invest in or deal with companies expect to benefit rather than lose from the experience, as 'creditors, workers, and customers will consent to deal with a corporation only if they expect to be better off themselves as a result'.[75] As a result, the corporation and its shareholders mutually have 'a direct pecuniary interest in making sure that corporate transactions are beneficial, not just to the shareholders, but to all parties who deal with the firm'.[76] Others for whom direct consent is not relevant but who might be harmed by corporate activity, and who might then stimulate or otherwise form part of public and political pressure for business regulatory and behavioural change to prevent such harm, similarly expect their interactions with corporations not to cost them benefits. Making a focus upon these real and interdependent benefits to shareholders the primary imperative of corporations and their managers therefore becomes the best way of ensuring that corporate law and business practice 'serve the broader goal of advancing overall social welfare'.[77]

Whether grounded alternatively in implicit social contracts, basic human goods and flourishing, maximum social utility and efficiency, or individual and communal well-being and happiness, law exists to serve society and, in particular, 'the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers without undue sacrifice – and, if possible, with benefit – to third parties such as local communities and beneficiaries of the natural environment'.[78] Understood in this way as an interdependent claim, the claim by everyone from corporate scholars and regulators to corporate directors and advisers that 'shareholder value' is and should be the dominant value in corporate law and practice carries a very different meaning from its cruder and one-dimensional versions.

Examples abound of similar expert views that can be interpreted broadly in the same way, in rejection of simplistic and absolutist versions of 'shareholder value', at one extreme of the spectrum, and 'stakeholder value', at the other. 'Balancing the shareholder's expectations of maximum return against other priorities is one of the fundamental problems confronting corporate management', in which '(t)he shareholder must receive a good return but the legitimate concerns of other constituencies (customers, employees, communities, suppliers, and society at large) also must have the appropriate attention', announced Business Roundtable in their 1981 statement on corporate responsibility.[79] Some commentators view Business Roundtable's 1997 update of that statement as 'a remarkable U-turn'.[80] Certainly, it conceives the governing dynamic as being that 'the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative of the duty to stockholders'.[81] Framing the relationship between stockholders and stakeholders in this way does not quite capture the senses in which the relationship of non-shareholder interests to corporate success is not simply derivative, except perhaps in the sense that running the corporation as a successful ongoing enterprise means ensuring that it has an optimal realizable value for shareholders if that point ever comes.

Has the advent of the Sarbanes-Oxley reforms of corporate and auditing accountability in the post-Enron era solidified or reversed this thinking? In its 2005 Principles of Corporate Governance, Business Roundtable endorses the view that 'it is the responsibility of management to operate the corporation in an effective and ethical manner to produce value for shareholders', while equally acknowledging that 'it is the responsibility of the corporation to deal with its employees, customers, suppliers and other constituencies in a fair and equitable manner'. Business Roundtable crystallises the foundations of corporate responsibility towards the corporate constituency in these terms:

> Corporations are often said to have obligations to shareholders and other constituencies, including employees, the communities in which they do business and government, but these obligations are best viewed as part of the paramount duty to optimize long-term shareholder value. Business Roundtable believes that shareholder value is enhanced when a corporation treats its employees well, serves its customers well, fosters good relationships with suppliers, maintains an effective compliance program and strong corporate governance practices, and has a reputation for civic responsibility.

'The basic responsibility of the company to society is not about benevolence, philanthropy, or solving the problems of the world; it is about conducting its business profitably in a way which matches the values of contemporary society in the treatment of its employees and of the physical and social environment in which it operates', argued the founder-chair of the Amnesty International UK Business Group, Sir Geoffrey Chandler, in response to the unfavourable treatment of CSR in *The Economist* in its 2005 CSR survey. 'Shareholder value should continue to be seen as the critical measure of business success', although 'it may be more accurate, more motivating - and indeed more beneficial to shareholder value over the long term – to describe business's ultimate purpose as the efficient provision of goods and services that society wants', which reflects 'the fundamental basis of the contract between business and society, and forms the basis of most people's real interactions with business', thus demonstrating the need for business 'to build social issues into strategy in a way which reflects their actual business importance', according to McKinsey & Company's worldwide managing director, Ian Davis.[82] On this view, corporate profits are not simply ends in themselves but can be viewed and sold to the public by CEOs as evidence of popular acknowledgement of business success in meeting the right society needs in the right sorts of ways.[83] Of course, these are sentiments with which Milton Friedman would be unlikely to disagree. This also reinforces the link between socio-economic dynamics, strategising, and risk.

This interdependence between business and social interests is a fundamental principle of socio-ethical responsibility, as well as a component in a wider account of socio-ethical responsibility embracing corporations and other societal institutions (eg governments), which itself forms part of a wider account of the intersections of national and international governance in the modern age. It is and should be the primary driver of national and international policy, corporate regulation and standard-setting, and business strategy and practice. At the same time, it does not represent the outer reaches of what might be sought by stakeholder pluralism or advocates of fundamental change to the shareholder-dominant centre of corporate law.

Meeting the company's interests by making it successful and hence enabling it to produce shareholder wealth over the long run does not equate to an obligation to any particular shareholder or group of shareholders at a particular point in time to increase their shareholder returns at all costs. If it requires a choice that benefits shareholders as a whole, even at the expense of non-shareholders, that choice is mediated and conditioned through the prism of what is in a corporation's interests, framed in terms of contributions to its continuing survival and success and how all of that relates to its corporate constituency. This is a richer notion than any one-dimensional notion that shareholder interests alone are important, that shareholder interests always trump non-shareholder interests, or that non-shareholder interests are relevant only in serving shareholder interests. In this richer notion of corporate success, the components of success do not frame the relationship between corporations and their shareholders and other stakeholders in such simple terms.

This is not code or even a call for something that will justify sacrificing shareholder interests to non-shareholder interests under the banner of clichés about stakeholder inclusiveness. It simply means that the outcomes favouring shareholder interests owe fidelity to a different and richer set of reasons about corporate success than those framed around clichés about shareholder primacy, enlightened shareholder value, and maximizing shareholder wealth, at least in their crudest forms. Whatever line-drawing arguments occur about respective responsibilities towards shareholders and non-shareholders ideally (that is, as a matter of moral, political, and other bodies of thought) or in reality (that is, as a matter of current regulation and practice), those arguments must occur within such a framework of corporate responsibility and governance. If this requires and leads to a clearer articulation of what is packed into the notion of corporate success and its component parts for these purposes – eg corporate size and growth, market share, profitability, shareholder wealth, stakeholder harm-minimisation, innovation, quality of production and service, competitiveness and industry standing, sustainability, public reputation, contribution to societal governance, contribution to the free enterprise system, and so on – that is no bad thing.[84]

Rethinking and Reframing Shareholder-Stakeholder Notions and Relationships

While I do not claim that the overall conception of corporate responsibility and governance informing this submission simply reproduces or even matches the current Australian and wider Anglo-American corporate law in every facet, it tracks and fits enough of that law to be a competitive conception in meeting present and evolving needs of corporate law. It also offers an account of some aspects of that law and its practice that cannot be accounted for adequately under some existing conceptions of the 'shareholder primacy' model, especially where those conceptions have gaps in their coverage or coherence.

For example, framing a corporation's interests and success around the dominance of shareholder interests across the board exerts a strong gravitational force on how directors view and treat both shareholder and non-shareholder interests. So, the particular choice of legislative vehicle for doing that matters, as does the prior choice to orient corporate law this way rather than some other way. Both the current Australian corporate law and even the proposed reforms of UK corporate law are clearly more shareholder-orientated than stakeholder-orientated in focus, emphasis, and legal incidents. That still begs the question of the particular conception of shareholder primacy informing the present legal position and reform options in each country.

The incompleteness, incoherence, and inadequacy of some shareholder-orientated conceptions of corporate responsibility and governance becomes clearer the more that the object of corporate regulation moves away from the model of a localized production-based corporation with a few original proprietors taking on significant investment risks in creating and running the corporation. Corporate law has evolved to accommodate some changes to this model, such as the complexity of corporations and the growth in shareholdings that require delegation of authority from shareholders to directors and manager as well as the separation of ownership and control. The selectivity apparent in why some shareholder-orientated evolutionary changes are incorporated without some stakeholder-orientated evolutionary changes also being incorporated before now is probably explainable by a combination of historical entrenchment, available standard-setting, dominant power relations, political and economic value-setting, business and legal conservatism, comparative modeling,[85] and evolutionary ripeness for reform.

The mono-dimensional equation of a corporation's best interests with its shareholders' interests breaks down if pushed too far in some directions. Shareholders do not equate to the company for all purposes, as a duty to the company as a sustainable enterprise over the long term is different from a duty to those current shareholders who want to maximise share prices for short-term trading. Recent cases at the highest Australian level confirm important limitations on the capacity of shareholders to excuse anyone from abusing corporate power, including their inability to ratify what would otherwise be a breach by directors of their statutory duties. Some recent Australian cases take differing approaches on the possibility of treating original company members differently from shareholders who acquire their shareholdings via share trading, at least for some legal purposes.

So, how should we conceive of this abstraction called 'the interests of the shareholders as a whole'? It is not limited to current shareholders, and can include future investors too, in the right circumstances. It is not limited to short-term and near-term benefits for current shareholders, and embraces shareholder benefits for shareholders as a whole over the long run. It needs to accommodate the different and sometimes competing interests of different classes and types of shareholders. It needs to embrace both financial and non-financial shareholder values.[86] It does not identify the only people with whom the company has legal or other relations. It does not identify a part of the corporation's constituency who have complete power under the law to do what they like with the corporation and its assets or even to legitimise everything its officials might do. On any view of what this abstraction means, maximising and sustaining the company's value (as well as the capacity and opportunity for that to be available and realisable for the benefit of shareholders as a whole over time) is not the same thing as doing whatever would most benefit current shareholders financially now or soon. That is one aspect of the imperative that truly underlies corporate law and drives corporate success. There are probably other aspects equally worthy of mention. None of them are captured fully or coherently by a one-dimensional and exclusive statutory shorthand linkage of corporate interests and present shareholder wealth.

Even from an economic standpoint alone, modern corporate governance appreciates that maximising shareholder value requires multi-dimensional attention and responses to corporate opportunities and risks from a variety of politico-regulatory, socio-economic, and environmental sources in the surrounding business climate. Shareholder and stakeholder interests are therefore relational and interdependent. Corporate law scholarship is still unable to decide conclusively whether these relationships are best viewed in terms of a compact between a company and its members, communitarian views of a company's social 'license to operate', a middle ground between contractarianism and communitarianism,[87] an account of corporate decision-making within what some call a 'team production' model of mediating hierarchies of shareholder and non-shareholder interests,[88] or something else. However, on any account of corporate responsibility and governance, the relational and interdependent interests of shareholders and other stakeholders demand recognition, whatever prioritising or other differentiating between these interests might also be involved.

One trend that is touched on in some submissions to the parallel PJCCFS inquiry is the fact that 'shareholder value' is not a mono-dimensional concept. On this view, there is not one single and financially focused shareholder value but rather multiple relevant shareholder *values*. Shareholders value a number of things *as shareholders* (as distinct, for example, from shareholding employees who, *as employees*, do not have interests that are co-extensive with what they might value *as shareholders*). Shareholders value ethical business conduct, environmental protection and sustainable development, non-participation and non-investment in socially problematic industries, non-exploitative business treatment of local and foreign employees, support for local products and businesses, and non-involvement in state and governance matters lacking integrity, Thus, 'shareholder values' is a more accurate description.[89] The AICD's PJCCFS submission lists external dynamics contributing to the push for socially responsible business conduct such as: media, investor, and rating agency interest in the social, environmental, and governance performance of corporations; acute sensitivity of corporate reputations, stock prices, and ‘brand’ values to reaction from corporate constituencies to unethical, illegal, and irresponsible behaviour; business capacity to attract and retain good employees, who care about the socially responsible activity and reputation of their corporate employer; and pressure for socially responsible behaviour from shareholder and stakeholder activists, lobbying groups, and mass litigation.

Now, if we unite the shareholder values that are internal to the corporate constituency (as well as congruent with socially responsible corporate behaviour) with the external features of the competitive and regulatory business environments that similarly drive the push towards business behaviour that is sensitive to social, ethical, and environmental concerns, we reach a point at which a rich notion of shareholder values creates an imperative to treat business corporations as economic, social, legal, and other kinds of institutions all at the same time.

Taking a broader and balanced view of all of these things - the range of interests truly encompassed within the corporate constituency, how those interests relate to one another, and how they should be factored into corporate decision-making directed towards the success of the company – allows for some results but not others, all of which still remain within the respective and special control of directors/executives as managers and shareholders as ‘owners’. Shareholder interests must be viewed in the long term and not just in the short term. Consideration of shareholder interests must occur within a wider context that includes the relationship between particular sets of shareholder and non-shareholder interests. Non-shareholder interests are entitled to due consideration, which is informed by their particular relationship to the company. Non-shareholder interests cannot ‘trump’ shareholder interests, except according to law (including all of the ways in which legitimate regulatory and non-regulatory norms of conduct bear upon business corporations to protect non-shareholder interests). Shareholder interests can ‘trump’ non-shareholder interests, in the ways permitted by law. Again, where shareholder interests prevail over non-shareholder interests, this happens not because non-shareholder interests are less politically or morally worthy than shareholder interests, or because non-shareholders do not have a relationship to the company, but rather because of the unique combination of control, accountability, and investment that forms the relationship between shareholders and the company.

Consider some examples. First, take the example mentioned by the UK Steering Group and cited in the CAMAC Discussion Paper (p 70). Assume that closing a plant will produce significant local redundancies, and that ending a long-term supply or distribution arrangement with another business will adversely affect the other business (perhaps even fatally), and that not closing the plant and ending the business arrangement will adversely affect shareholder returns. The Steering Group describes this outcome in terms of the ultimate need for shareholder interests to override other interests in these situations. It goes on to frame this outcome in terms of a choice about ‘whether “the company” is to be equated with its shareholders alone (enlightened shareholder value [‘ESV’]) or the shareholders plus other participants (pluralism)’.[90]

On this account, ESV is revealed to mean nothing more nor less than that non-shareholder interests deserve consideration in the course of deciding what is in a company's best interests but must give way to shareholder interests where the two compete, not simply in the abstract but in their respective impact upon one or more dimensions of the company's sustainable success as a profitable, beneficial, and responsible enterprise. In the examples given, the success of the company requires a choice to be made between the competing interests, not simply in terms of favouring one interest over the other but relative to their respective impact upon the company's ultimate success. In that calculation, different dimensions of what it means to be a successful company might be in play and interact, in ways that do not necessarily involve a straight competition between opposing interests. The sustainable success of a company in being a responsible employer and business contractor in the local community is contingent upon its sustainable success as a profitable business enterprise, so that continuation of existing employment and business arrangements come what may is not ultimately sustainable. Continuing the plant and the business arrangement is prejudicial to the company's long-term success as an ongoing business enterprise and hence the returns it can make to shareholders in the long run.

At the same time, funding greater returns to existing shareholders by closing a plant or ending a business arrangement that is integral to the company's long-term success would not be justified. Similarly, deciding to close the local plant and to end the business arrangement only as a measure of last resort, and to cut each some more slack before reaching that point of no return, might be justified on a coherent view of the company's success overall. In each case, the equation is more complex than a straight competition between conflicting interests in the abstract, even if it ultimately requires a choice between conflicting interests because of how each of them bears upon an integrated overall view of the company's success. In the case of both shareholders and non-shareholders, each has a legitimate expectation of due consideration of their interests, avoidance of unjustified harm to their interests, and benefit to their interests – not at large as a straight and simple competition of interests per se, but within the dynamics of the relationship between a corporation, its constituency, and its success.

So, where the ongoing viability of the company and its capacity to service all of its constituent groups, including the continued employment of other employees as well as investment returns for shareholders, are threatened by financial disaster if it does not close or relocate one of its local plants, for example, what looks like a direct competition between shareholder and non-shareholder interests is transformed by this conception into one whose resolution is achieved by reference to the overriding consideration of the company's survival and success. In that equation, the interests of the employees at the local plant, the interests of other employees, and the interests of shareholders are individually and collectively aligned to the company's interests and success in ways that do not simply juxtapose them as competing interests for their own sake. This is consistent with the way in which experienced directors view and exercise their decision-making role, although they all would not necessarily conceive of it in exactly the way just described.

The relationship between non-shareholder interests and corporate success (as defined here) also explains why the company does not stand in a relationship with non-shareholders that imitates or replaces their relationship to, say, government and the responsibilities flowing from this latter relationship. This is why the responsibility of a government towards human rights holders and others is different from any responsibility that a company might have towards them, even allowing for the nature of companies as societal institutions with societal responsibilities.

Dealing with the Orientations and Outcomes of Previous Official Inquiries on CSR

The underlying assumptions and ultimate value-positions about CSR adopted in previous corporate law reform efforts in Australia and overseas, including the current reform of UK corporate law, should not prevent the current parallel inquiries from considering the matter afresh and, importantly, in the light of current, evolving, and different circumstances. The conclusions of some previous official reviews of corporate law reform were influenced not only by prevailing regulatory and business views about desirable corporate law reform, and judicial and academic thinking about the state and development of corporate law at those times, but also by the state then of CSR evolution and standard-setting nationally and internationally, as well as adverse reactions to particular ideas about creating duties to non-shareholders and the non-manageability of extreme forms of stakeholder pluralism. They also predate subsequent major CSR inquiries such as the UK Company Law Review Steering Group's review of CSR and other aspects of UK corporate law reform. All of this affects the underlying assumptions, value-positions, and rationales of the conclusions in past Australian inquiries investigating CSR. For these reasons, neither CAMAC's recommendations nor those of the parallel PJCCFS inquiry should simply mirror or otherwise fall into line with the recommendations of earlier inquiries, such as the Senate Standing Committee on Legal and Constitutional Affairs' 1989 report, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*. In other words, there are good reasons why divergence from past conclusions is justified, without undermining the soundness of those conclusions at the time that they were made. In that sense, CAMAC is free to chart a different course in policy terms.

Lessons from US-Style Constituency Statutes

In its discussion of US constituency statutes, the CAMAC Discussion Paper fulfils its role of highlighting key features and arguments about them, in their own right and as one option in promoting CSR. At the same time, it does not purport to cover all features and arguments about them. A brief survey of some of the history and forms of corporate constituency statutes in various US states, supplementing CAMAC's own discussion of this area in its Discussion Paper, highlights the choices that need to be made in constructing a suitable model for Australian adaptation.

By the end of the 20th century, American corporate constituency statutes promoting interests beyond shareholder interests had been enacted in many American states. Characteristically, they empower corporate executives to consider a wide range of interests in corporate decision-making, including the interests of employees, customers, creditors, and local communities. Their impetus lay in equivalent amendments to corporate charters by members, the long-standing debate about corporate social responsibility, the rise of stakeholder theory in influential American business and management schools, and the need for legislative anti-takeover protection in the USA in the 1970s and 1980s.[91] Commentators accept that many of the constituency statutes in American states were introduced from the 1980s onwards not simply to guard against undesirable takeovers as such, but to ensure that state employment and services provided by those companies would not be adversely affected by the resultant asset-stripping, sell-offs, and lay-offs inevitable resulting from some takeovers. So, properly viewed, they either cannot be seen simply as an anti-takeover device, or else their anti-takeover role must be assessed by reference to the background interests thereby served.[92] On either view, the context of their introduction does not preclude their applicability to CSR.

On a wider level of comparing different CSR options, even the constituency statutes reflect a deeper imperative for companies to have regard to the relevant interests of employees, customers, suppliers, and local communities. The takeover-focused context of those statutes does not totally exhaust that deeper imperative. That same imperative is reflected in a different context in European and other models that enshrine employee interests in corporate governance. It is reflected partially in the existing statutory and non-statutory recognition of employee entitlements and creditor interests in situations of insolvency under Australian law. In other words, it would not be as dramatic a shift with the underpinnings of Australian corporate law as some might think to clarify or create the need for directors to take some account of non-shareholder interests in their decisions and actions.

Accordingly, CAMAC should not allow the anti-takeover context of US constituency statutes and the relative scarcity of cases applying them to CSR contexts to downgrade their potential usefulness as a serious option for consideration in Australia, especially in light of the commonality between some factors characteristically found in constituency stats and the hybrid UK proposal. The historical context of constituency statutes does not wholly determine or exhaust their content or their potential applicability to CSR contexts.

Consider just a few brief examples, which illustrate the kinds of drafting questions and choices that result if US-style constituency statutes are introduced in Australia. Minnesota's corporate law ties the duty of directors to the interests of the corporation as a whole, requiring directors to exercise their duties 'in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances'. It also contains a corporate constituency provision that allows directors, 'in considering the best interests of the corporation', to 'consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation'.

Similarly, New York's corporate constituency provision in its corporate law says:

> 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.

It adds the following proviso concerning the duty of directors:

> 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.

Pennsylvania's corporate law outlines its corporate constituency provision in the following way:

> In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a business corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate:
>
> (1) The effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.
> (2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.
> (3) The resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation.
> (4) All other pertinent factors.

Pennsylvania's law adds the following rider about how directors weigh different interests:

> The board of directors, committees of the board and individual directors shall not be required, in considering the best interests of the corporation or the effects of any action, to regard any corporate interest or the interests of any particular group affected by such action as a dominant or controlling interest or factor. The consideration of interests and factors in the manner described [here] shall not constitute a violation of section 1712 (relating to standard of care and justifiable reliance).

An enhanced directors' duty to consider non-shareholder interests could encompass a number of different elements, and does not necessarily have to encompass all of them. The list of elements includes:

(1) identifying relevant non-shareholder interests generally or for particular purposes;
(2) adequately informing the decision-makers of relevant non-shareholder interests;
(3) taking relevant non-shareholder interests into account in decision-making;
(4) advancing non-shareholder interests where that is necessary for the company's success;
(5) seeking and preferring options that benefit shareholders without causing undue harm to non-shareholders;
(6) making non-shareholder interests subordinate to shareholder interests, or otherwise treating non-shareholder interests as derivative of shareholder interests;
(7) justifying decisions that are at the expense of non-shareholders or that otherwise do not advance their interests; and
(8) building identification and consideration of relevant non-shareholder interests into ordinary corporate processes, procedures, and documents covering corporate strategy, risk assessment, standard-setting, policy-making, and reporting.

Accordingly, if CAMAC decides that some form of corporate constituency legislative model might be suitable for Australia, CAMAC should then focus its attention upon the following crucial issues in framing options for an Australian model:

(1) Whether directors and managers are under a legally enforceable and remediable duty of some kind to non-shareholders to avoid undue adverse harm to non-shareholder interests, such as in the Model Uniform Code for Corporate Responsibility tabled for consideration in some US states – I do not believe that Australian corporate law and practice is ready to make the jump from its current state to this new state of affairs;
(2) Whether directors and managers are simply entitled or alternatively obliged to consider all specified groups comprising the corporate constituency;
(3) Whether the appropriate standard of consideration is 'weak' consideration (ie consideration and subjugation of non-shareholder interests without cause), 'strong' consideration (ie consideration and subjugation of non-shareholder interests for justified cause), satisfaction, or maximization;[93]
(4) Whether this obligation is embodied within a new and overriding statutory duty or alternatively incorporated within one or more of the existing statutory duties of directors, with the most likely candidates being one or both of the 'care and diligence' duty and the 'good faith' duty;
(5) Whether this enhanced directors' duty to consider stakeholder interests applies generally or should be confined to certain categories of decision-making (eg major or 'high impact' decisions (as defined), decisions about corporate control etc);
(6) Whether a director's entitlement or obligation to consider non-shareholder interests along with shareholder interests is to be assessed objectively or subjectively, in terms of what they believe or is in the interests of the corporation;
(7) Whether this enhanced directors' duty to consider stakeholder interests should apply to all corporations or only some (eg large publicly listed corporations);

(8) Whether directors and managers are offered a statutory or other kind of regulatory framework or statutory matrix of decision-making factors accommodating non-shareholder interests;
(9) Whether directors and managers are legislatively directed to give shareholder interests some kind of priority or even paramountcy, or alternatively to give no special priority to any one particular constituent group;
(10) Whether breach of the requirement to consider non-shareholder interests can generate any actions and remedies for non-shareholders for breaching it; and
(11) Whether other kinds of regulatory monitoring, intervention, or enforcement mechanisms are needed to put companies 'on notice' about inadequate consideration of non-shareholder interests (eg tabling of ASIC/ASX monitoring reports on this aspect in parliament).

A model CSR law on directors' duties needs to distinguish between two basic and different things – namely, the range of interests within the corporate constituency to which directors and managers can have regard, on one hand, and the chief considerations in having regard to those constituent interests, on the other. The fact that some US constituency statutes go on to direct corporate executives and managers not to favour the interests of any particular constituent group emphasizes the need to recognize the distinction between relevant interests and how they are considered. One unhelpful feature of the UK proposal and some US state constituency statutes is that they list relevant decision-making factors for directors and managers in a form that simply combines and conflates these two things. Better decision-making is promoted by recognising both their distinctiveness and their relationship, and building that into the regulatory framework, if this option is chosen.

Conceptualising the Interests of the Corporation

One of the members of the Steering Group for equivalent UK reforms, Professor Paul Davies, crystallizes its overall package of measures as follows:[94]

> (W)e endorsed the traditional shareholder-centred philosophy of British company law, but advocated a modernized version of it, which we dubbed 'enlightened shareholder value'. Second, the ESV approach showed itself not only, or, in my view, even most prominently, in the formulation of directors' duties, but also in the additional mandatory reporting requirement contained in the OFR. It's not an exaggeration to say that the OFR was, in the eyes of many people, the other side of the bargain in which a relatively traditional formulation of directors' duties was adopted … Thus, there is not doubt that the CLR's formulation of the basic objective of directors' duties is towards the shareholder, rather than the stakeholder, end of the spectrum.

Professor Davies crystallizes the conception of a corporation's interests and the relationship of those interests to directors' duties in the original UK proposal as follows:[95]

> (T)he crucial question is what the statutory statement says about the interests which the directors should promote when exercising their discretionary powers. The common law

> mantra that the duties of directors are owed to the company has long obscured the answer to this question. Although that is a statement of the utmost importance when it comes to the enforcement of duties and their associated remedies, it tells one nothing about the answer to our question, whose interests should the directors promote? This is because the company, as an artificial person, can have no interests separate from the interests of those who are associated with it, whether as shareholders, creditors, employees, suppliers, customers or in some other way. So, the crucial question is, when we refer to the company, to the interests of which of those sets of natural persons are we referring? Of course, one could take the view that the beauty of referring to the interests of the company, without any further specification of what is meant, is that the answer to my question is left wholly ambiguous and obscure. This may be a way of avoiding political controversy but it does not generate transparent law.
>
> In any event, the government does propose to specify what is meant by the interests of the company and to adopt the majority view of the prior common law, ie that the company means its members, normally, therefore, the shareholders. Thus the draft Bill states as follows (note the user-friendly drafting style):
>
> > As a director of a company you must act in the way you consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.
>
> This is, I think, clear, and it's pleasing to note that the meaningless phrase 'in the interests of the company' has altogether disappeared. However, this formulation does not so far have much [of] an ESV quality about it. The ESV element is to be found in the further provisions that 'in fulfilling the duty imposed by this section you must take into account (where relevant and so far as reasonably practicable)' a number of further matters.

The actual wording in the UK's draft Company Law Reform Bill has been updated slightly from the provision quoted here. Professor Davies and I agree on some key outcomes, such as the need for reforms that inhibit directors from 'riding roughshod' over non-shareholder interests, as well as the characterization of non-shareholder interests in the directors' calculus as being more akin to a 'tort-like' harm-avoiding interest than a fiduciary-like advancement of an interest, except to the extent that benefiting non-shareholders also benefits shareholders, at least under prevailing corporate law. We might even agree on the formulation of a director's basic obligation 'to promote the success of the company for the benefit of its members as a whole', if running the company 'for the benefit of its members as a whole' means running it in ways that respond to the components of corporate success and their relationship to a corporation's constituency, as outlined in this submission.

Even that formulation can be recast in terms of a form of shareholder primacy, in the sense that a successful corporation over time has a realizable value for shareholders upon its ultimate demise and distribution of residual assets after meeting all claims. That conception of shareholder primacy and the collective interests of shareholders is itself an abstraction. It does not translate simply into the actual interests of those who happen to be shareholders at any fixed point in time. It does not avoid the need to balance the different needs of different shareholder groups, even allowing for the tighter common interest they have as shareholders than other stakeholders have. It does not dissolve the need to accommodate the fact that there is not simply a single financial corporate bottom line that all shareholders value, but rather a range of different financial and non-financial shareholder values.[96]

Despite Professor Davis' adverse comments here about the meaningfulness of the notion of 'the interests of the company', I do not read them as absolutely precluding the possibility of an account of corporate responsibility that makes reference to 'the interests of the corporation' in a meaningful way. In context, what he rightly criticises is reference to that notion as a free-standing notion of no fixed meaning, without any self-evident means of identifying the set or sets of interests from the corporate constituency encapsulated in that notion. Identifying the relationship of different groups within the corporate constituency to one another as members of a common corporate constituency, and their contributions to the corporation's success, might be difficult and also might even present some intractable competitions of interests, but it is not incoherent or otherwise 'meaningless'.

CAMAC and Conceptual Models of Directors' Duties

CAMAC's CSR Discussion Paper frames discussion of possible directors' duties reform around two alternative and diverging approaches – namely, what it terms 'a pluralist approach' and 'an elaborated shareholder benefit approach' (p 63). The first approach is summarized as one 'under which other certain stakeholders would be on a par with shareholders'. Here, the devil is in the detail of what 'on a par with' really means in this context. The second approach is summarized as one 'being an explicit statement of interests for directors to take into account in advancing the financial well-being of shareholders generally'. Here, non-shareholder interests are still framed largely or wholly as interests whose value in this context derives from their instrumental service to 'the financial well-being of shareholders generally', which is simply one – admittedly an important one - of a number of shareholder values.[97]

These two alternative approaches are helpful starting points for highlighting worthy aspects and juxtaposing viable but competing alternatives. Other permutations of them and alternatives to them are also worthy of inclusion in the menu of reform options. For example, CAMAC faces a basic choice between at least five different ways of conceptualizing and regulating the relationship between shareholder and non-shareholder interests:

(1) an approach based on equality, in the sense of equality that requires treating shareholder and non-shareholder interests as being of equal worth, consideration, and responsibility for directors (which might also approximate some forms of 'stakeholder pluralism');

(2) an approach based on 'fairness', with dimensions that are both internal and external to the organization, under which the interests of shareholders and non-shareholders are treated 'fairly' (but not necessarily equally) as between themselves and other interests;

(3) an approach based on exclusive shareholder-centeredness, in which no need or responsibility to consider and give effect to anything other than shareholders' (financial and non-financial) interests ever arises;

(4) an approach based on shareholder primacy, in the sense of shareholder primacy in which non-shareholder interests are not only subordinate to shareholder interests but derive their only value in this context from their service to shareholder interests (however shareholder interests are conceived); and

(5) an approach in which due differential consideration is given to shareholder and non-shareholder interests as constituent parts of the corporation's constituency, relative to the relationship between the corporation and each part of its corporate constituency as well as how advancing, protecting, or refraining from harming each interest benefits the corporation in particular circumstances.[98]

Assessing the UK's Proposed Reform of Directors' Duties and Corporate Reporting

The current reform of directors' duty proposed in the UK in the Company Law Reform Bill, to mandate that directors must consider designated shareholder and stakeholder interests in fulfilling their corporate duties, was summarized in parliamentary debate on the Bill in January 2006 as follows:[99]

> The duty to promote the success of the company answers one of the fundamental questions in company law: 'in whose interests should companies be run?'. In line with the recommendation of the Company Law Review, the Bill's answer is that directors should run the company for the benefit of its members collectively. However, directors will not be successful in promoting the success of the company if they focus on only the short-term financial bottom line. Successful companies see business prosperity and responsible business behaviour as two sides of the same coin. That is why, in line with the recommendation of the Company Law Review, the Bill adopts an approach known as 'enlightened shareholder value', under which a director must, in promoting the success of the company, have regard to factors such as the long-term consequences of business decisions and the impact of the company's activities on employees, the community and the environment.

The UK model is a hybrid model. It grafts some elements of constituency statutes onto a shareholder-centred account of directors' duties. Commentaries by those closely involved with the UK Steering Group suggest that the quid pro quo for maintaining a shareholder-centred view of directors' duties was the bolstering of socially responsible reporting elements in the OFR. [100] The pushback from that position in the UK's recent suspension of the OFR arguably upsets the balance of measures in the total UK reform package and, to that extent, undermines the rationale for keeping enhanced stakeholder-based elements out of directors' duties except in their relation to shareholder interests. Similarly, if Australia rejects any enhancement of obligations concerning non-shareholders in directors' duties, the case for the quid pro quo of enhanced reporting obligations increases. Obviously, the framing, content, and scope of any such reporting obligation makes or breaks it. Requiring a company to report in detail on everything it does to promote non-shareholder interests and to avoid harming them is likely to be more costly, less focused, and less conducive to meaningful disclosure than framing a reporting obligation around outcomes directed towards trust-building and mutual advantages for companies, shareholders, and non-shareholders.[101]

At least four modifying factors are relevant to any assessment of equivalent UK developments and their customized transposition to Australian conditions. First, neither the UK's proposal to remove reference to a corporation's (best) interests from the duty formulation nor its exclusive linkage of a company's success with benefit to its members alone is duplicated habitually or characteristically in other Anglo-American legislative statements of directors' duties. However these terms are interpreted, express references to a company's best interests appear, for example, in Australia's Corporations Act in the 'business judgment' defence to the duty of care and diligence (section 180(2)), the duty of good faith (section 181), and provisions enabling directors of subsidiaries to act in the holding company's best interests (section 187).

Secondly, there is a critical interplay between subjective and objective elements in the formulation across Anglo-American jurisdictions of directors' duties, any 'business judgment' defences,[102] and any express or implicit entitlement or obligation to consider particular interests. Account must be taken of that interplay, so that something entitling or obliging directors to consider non-shareholder interests, as part of fulfilling a directors' duty with a particular mix of objective and subjective elements, is not transported without suitable modification to an Australian environment with a different mix of those elements, and with a different permutation of the basic three components of duties, defences, and interest-sensitivity.

Thirdly, the OFR was an integral part and balancing factor in the overall corporate law reform package in the UK, and so its clarification and reform of directors' duties cannot properly be considered in isolation from the OFR as originally conceived. As indicated above, the OFR's stakeholder-sensitivity was a trade-off for enshrining a more conventional shareholder-orientated notion of directors' duties in the law.[103] Nothing in the UK Government's recent about-turn on the OFR detracts from this important point. Nor does that about-turn or even the particular way in which the UK OFR requirements made social and environmental factors relevant preclude embedding something suitable about that in existing Australian mechanisms for reporting financial positions, risk assessment, business strategies and prospects, and operational reviews.[104]

Fourthly, the UK proposal to oblige directors to take account of specified interests and factors has strengths and weaknesses that need to be kept in mind in its evaluation and any customized adaptation for Australian conditions.

In light of that important background context, the UK's proposal can now be assessed.[105] The draft legislation says:

> **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.

> (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, his duty is to act in the way he considers, in good faith, would be most likely to achieve those purposes.
>
> (3) In fulfilling the duty imposed by this section a director must (so far as reasonably practicable) have regard 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.
>
> (4) 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.

Note the following features of this UK proposal. It is a mix of elements of different characters - express shareholder-sensitive elements (eg 'act in the way [that] would be most likely to promote the success of the company for the benefit of its members as a whole'), express stakeholder-sensitive elements (eg 'the interests of the company's employees'), intra-constituency decision-making factors (eg 'the need to act fairly as between members of the company'), and general decision-making factors (eg 'the likely consequences of any decision in the long term). It rests on a particular view of the relationship between shareholders, other stakeholders, and corporate responsibility. It completely identifies 'the success of the company' with 'the benefit of its members as a whole', in a way that conflates those two things to the exclusion of other aspects of the relationship between corporate responsibility and corporate constituencies. It strongly retains a form of shareholder primacy, and all of its stakeholder-inclusive elements must be read subject to that overriding norm. It compels directors to consider particular non-shareholder interests where necessary, as distinct from merely clarifying that they are entitled to do so, but it does not illuminate anything about when and how this might be 'reasonably practicable' for directors. That is left for the courts or other forms of regulatory guidance.

Its mandatory nature extends only to an obligation to take account of particular interests, as distinct from an obligation to give effect to them. An obligation to take non-shareholder interests into account in corporate decision-making falls way short of an obligation to protect or give effect to those interests. In other words, it is directed at requirements to consider interests but not the dynamics in considering them or any outcomes. Stripped of its mandatory commands, it contains elements of what directors are probably entitled to do already under Australian law, in terms of being entitled to consider non-shareholder interests where necessary to meet their corporate obligations. It presumes but makes no contribution towards measures for assessing and deciding between different shareholder and non-shareholder interests. Many of these features are problematic.[106] It is no answer here to say that such changes in the law could be supplemented and worked out by other forms of regulatory guidance, without building that connection more forcefully into the legislative framework. In the Australian context, such a change could usefully be linked to, and bolstered by, supplementary guidelines for decision-making cooperatively developed through the ASX CGC, which would facilitate a regulatory 'meeting of minds' between 'top down' mandatory law and 'bottom up' development of regulation.

CSR Reporting Consolidation and Reform

Some avenues for improving CSR do not involve changes or clarifications to directors' duties at all. Corporations are either committed to being socially responsible, or they are not. The question on the reporting side is whether there should be a blanket need to report that a company is committed to corporate social responsibility or not, and the nature and extent of reporting required. If any corporation operating in the public domain does not claim to be socially responsible, at least in ways that society can agree upon as fundamental ways in which business should be socially responsible, and also says that it should not be under a legal obligation to consider non-shareholder interests in corporate decision-making, that is its prerogative. However, there is an arguable policy case that it should have to declare that publicly, justify why being socially responsible in those ways is inapplicable to its circumstances, and take its chances in a field of competitors who make their own socially responsible business behaviour a competitive selling point with their corporate constituency. Alternatively, the reporting obligation could be more focused, and limited to corporations that claim to be socially responsible, in terms of requiring them to justify how they verify that claim, beyond self-publicity.[107]

Of course, the principle that an organization operating in the public domain that claims to be socially responsible must justify and verify that claim has application beyond corporations. However, CAMAC would be justified in confining its attention to corporations on this point given: (i) its Terms of Reference; (ii) the position and impact of corporations (especially large business corporations) in society; (iii) the special capacity of large business corporations to harm or benefit stakeholders; (iv) the different cost-benefit impact of additional CSR reporting and accountability for NGOs (and perhaps SMEs too); and (v) the fact that how corporations engage in business in socially responsible ways is different from how, say, NGOs otherwise serve social ends. So, even if there are other satisfactory reasons that justify social responsibility for a wider class of entities including but not limited to corporations, CAMAC would still be justified in confining its recommendations to the responsibility of corporations.

In the case of both the blanket and claim-based reporting obligations, the five main things that need demonstrating, justifying, and verifying in any reporting are:

(1) how the corporation informs its decision-making about stakeholder interests;

(2) how the corporation takes stakeholder interests into account in decision-making, including risk assessment, measurement, and justification of any potential adverse impact upon non-shareholder interests;
(3) how the corporation facilitates consultation and representation of stakeholder interests, and how the corporation otherwise communicates with and reports to stakeholders (including shareholders);
(4) how stakeholder interests are factored into the corporation's strategic planning, risk assessment, and other elements of its operations and financial review; and
(5) how the corporation ensures that all of this information is valid and verifiable.

Obviously, there will be disagreement about what level of reporting is appropriate on a cost-benefit analysis on these five main items, both individually and collectively.

All of this could be aligned with amplified guidance from the ASX CGC on building stakeholder-sensitive interests into the existing ASX CGC principles and recommendations concerning risk assessment and stakeholder inclusiveness.

A truly effective policy of continuous disclosure, and a good regulatory and business culture of transparency, require reporting that is matched in its nature and level of detail to the real needs of its intended audience(s). As some of the submissions to the parallel PJCCFS inquiry argue,[108] neither Australia nor any other Anglo-American jurisdiction necessarily has the balance exactly right yet on the volume, type, and specificity of reporting and the worth of publicly reported information to stakeholders. Any additional CSR-centred reporting must also be positioned within the wider issue of ongoing necessary review and reform of corporate reporting generally. Indeed, some of the objections to CSR reporting received by CAMAC and the PJCCFS might be better viewed as general objections to additional corporate reporting obligations of any kind, given the current reporting burden. If so, there might be less force in such objections if a regulatory trade-off is possible, under which the CSR-sensitivity and meaningfulness of reported information for its target audiences is enhanced while the overall level and detail of less meaningful reporting is reduced or otherwise streamlined.

This could also be part of wider governmental monitoring and review of the impact of current reporting regulation generally. In that way, CSR-sensitive reporting is seen in its proper background context. This requires a commitment by the Federal Government to gather evidence about and review corporate reporting needs and practices, as part of its ongoing monitoring of the effectiveness and efficiency of CLERP 9 reforms, with a view to enhancing meaningful CSR reporting and, where possible, reducing the volume and detail of reporting that is not really meeting the needs of its intended audiences.[109] This could itself be part of a wider governmental commitment to developing a coordinated and overarching CSR policy framework of relevance to government and non-government organizations alike, as in the UK.

Embedding CSR-centred reporting within the existing framework for corporate strategy, risk assessment, and operational and financial reviews (including what is required under directors' reports) requires a threefold balance between quantitative/qualitative information, financial/non-financial information, and an internal (organizational)/external (societal) orientation in strategy and operations. Currently, financial and quantitative information still dominate this equation. This is to be expected in an environment where companies are more likely to have strategic and financial plans than human rights management and CSR plans, the bulk of standard-setting nationally and internationally is still more financial than social and environmental in focus, and CSR imperatives and practices are still evolving both inside and outside companies. Similarly, until better regulation and standard-setting is achieved, even those conducting forward-looking operational and financial reviews who are CSR-sensitive might find it easier and safer to fulfil their institutional responsibilities by concentrating more upon 'hard' financial information, and the body of existing standards supporting its reliable assessment from a risk management perspective, than upon socially and environmentally relevant contextual factors beyond mere legal compliance, even where they relate to corporate opportunities and risks. Of course, what CAMAC recommends and what the Federal Government decides based on that recommendation influence this evolution too, one way or the other.

Where possible, any additional corporate reporting to accommodate socio-economic, environmental, and sustainability concerns should be built into the existing regulatory framework, including existing mechanisms such as the ASX CGC principles and recommendations and other official or industry guides. This should be done on the same 'comply or explain' (of 'if not, why not?') basis. At the same time, it needs to be made clear that this does not mean that business corporations have a choice whether or not to engage in this form of reporting, especially if other trade-offs are achieved that reduce or streamline the overall volume and detail of reporting. Any choice must relate to the form of the reporting and the justification of divergence from the recommended position. Some large companies, for example, might work within their existing social reports and rating agencies reports for this purpose.

Whatever CAMAC recommends, there are important regulatory values that could be served in the right way by corporate reporting that is more sensitive to at least some forms of CSR. In a famous example from their ground-breaking text, *The Economic Structure of Corporate Law*, Judge Frank Easterbrook and Professor Daniel Fischel argue from a 'corporate contracts'-based perspective that the New York Times could be justified in abandoning profit-making and embracing even altruistic and community interests through newspaper publishing, if it disclosed that to its equity investors and other stockhholders and secured their agreement.[110] Similarly, Whole Foods founder-CEO, John Mackey, recently denied that his company's commitment in its mission statement to donating five percent of net profits to philanthropic causes, as unanimously approved by the original owners and known and accepted by subsequent investors, amounted to philanthropic 'theft' from the company's investors.[111] Yet all of this is explainable in terms of corporate responsibility as one application of the principle of transparency. This principle has wider dimensions. 'Transparency is emerging as the triumphant principle in the globalization of companies and securities regulation', given that '(t)he big picture of the history of the twentieth century is that every nation is corporatized and securitized, some more completely than others', and that '(t)he decisive regulatory idea is transparency, demanded of US securities markets by the SEC, [and] transmitted by the New York Stock Exchange and US accounting firms as a global regulatory ideal when investment globalizes', as regulatory theorists and professors John Braithwaite and Peter Drahos conclude in their ground-breaking global analysis of business regulation.[112]

This fundamental politico-regulatory value of transparency also applies to consolidation and reform of CSR reporting obligations. If companies launch major CSR initiatives or comprehensive social reporting, and this is a marked departure from their prevailing business orientation and strategy *and* the basis upon which original investors and other stockholders have invested in those companies, there is an issue about the need and adequacy of advance disclosure of that, not least in service to the fundamental value of transparency. If companies (or anyone) make public claims about conducting their business in socially responsible ways, and seek to gain a competitive or reputational advantage, secure employee commitment, attract finance and investment, or solidify relations with governments or communities because of that, those claims should be explainable, justifiable, and verifiable.[113] If practicing business in socially responsible ways is coming to be regarded as an important item of information that factors into investment decisions by some groups of individual and institutional investors, transparency demands that all companies in which the public might invest disclose and report meaningfully on this aspect of their business operations and strategy. If companies choose not to make socially responsible business behaviour and other legitimate CSR outcomes a major part of their business, when others of the same size and nature in the same industry sector do, that choice is theirs but it should come at the cost of declaring and justifying that choice and those levels of CSR engagement. Even if CAMAC decides not to recommend additional CSR-based reporting obligations generally, these particular and narrower situations still deserve some attention.

Viewed in these ways as something integrally connected to meaningful disclosure and reporting of information needed by the public and investors, this particular aspect of CSR is not simply something that operates as a socially required constraint on business or that is properly confined to socially relevant reporting in particular areas (eg environmental compliance). Rather, it infuses ordinary business thinking and practices about operations, strategy, and risk. It will be a wasted opportunity if at least these limited forms of CSR reporting are not further embedded and enhanced through a variety of means, as part of a wider commitment to reviewing and even reducing the overall volume and detail of corporate reporting introduced in the wake of CLERP 9, and also as a trade-off for more meaningful reporting for the public and investors, especially in the area of CSR. Whatever other objections might be made to this, it cannot be characterized and dismissed simply as a call for additional, burdensome, and unnecessary reporting obligations for business corporations.

Depending on what else CAMAC recommends, clarifications or changes to directors' duties and reporting obligations might need to be considered in tandem. It would be less than ideal, for example, to ask companies to report on *how* they take non-shareholder interests into account without also indicating that companies *can* or *must* take those interests into account.

Conclusions and Recommendations

A Governmental CSR Policy Framework

Here is the rub. If, on balance, there is a need to bolster regulation inside and outside the law to enhance CSR consideration and reporting, there is an equally pressing need for a governmental CSR policy framework akin to that developed by the UK Government, within which such bolstered regulation can properly sit, along with a range of other CSR initiatives across the public, private, and community sectors. Taking CSR seriously from a governmental perspective neither starts nor ends just with a focus upon changes to directors' duties and corporate reporting obligations. Such a confined focus does not necessarily point the way towards CSR partnerships and networks between government and non-government bodies, for example.

A CSR reform package that goes straight to, and only focuses upon, a couple of the areas that the UK experience proves are part of a wider, integrated, and coordinated governmental approach to CSR is not as good as a reform package that looks beyond business responsibility in the areas of directors' duties and corporate reporting, and towards these wider aspects. CAMAC's Terms of Reference[114] implicitly permit such wider recommendations. The Federal Government has an important framework-setting start-up role here, which conveniently builds upon its existing CSR initiatives.[115]

So, at the outset, both CAMAC and the PJCCFS should be suggesting to the Federal Government that it better coordinates and facilitates all of the different contexts in which CSR policy, regulation, and standard-setting are occurring now and in the near future. It is unwieldy having two parallel federal CSR inquiries with overlapping terms of reference and submissions, CSR-related issues arising in different portfolio contexts[116] without a transparent and overarching policy approach, and CSR standard-setting spread across the Corporations Act, other socio-economic and environmental legislation, various principles and recommendations from the ASX CGC, and various non-governmental authoritative sources (eg Standards Australia's Standard AS 8003 *Corporate Social Responsibility*). This need for better coordination, facilitation, and streamlining is only part of a greater need for a governmental CSR policy framework and overarching strategy.

There is no escaping this need. CSR in some form is here to stay nationally and internationally. Australia's choice is to steer actively and become a world leader in CSR-sensitive regulation and standard-setting, or else be buffeted and overrun by CSR's momentum and multiple manifestations. Transnational and international standard-setting on CSR remains 'a very "fluid" area'.[117] CSR reporting by companies has grown significantly worldwide in the last decade, with its orientation changing from a focus mostly on environmental reporting towards including sustainability reporting along the social, economic, and environmental dimensions of the 'triple bottom line'.[118] These aspects are increasingly integrated with corporate governance mechanisms and reporting, under the impetus of reporting models and ratings systems that focus attention upon what is sometimes called the ‘quadruple bottom line’ of a company’s performance, which counts and integrates its performance in terms of good governance with its performance economically, socially, and environmentally. Adding in enhanced responsiveness to risks associated with the politico-socio-regulatory landscape effectively creates a ‘quintuple bottom line’, within which CSR is fully integrated into standard business operations of strategizing, risk management, decision-making, disclosure, and reporting.

Starting with a governmental CSR policy framework akin to the UK’s CSR policy framework would stimulate CSR awareness, facilitation, and coordination, and give CSR an appropriate policy priority in government, which has an important flow-through effect in galvanizing and orientating departments and agencies to support the government, business, and the community in this policy field. It would give the government important control over CSR policy direction, in setting the framework within which other reforms might happen, including present attention to directors’ duties and reporting, but would also be capable of encompassing international CSR developments and standard-setting as they evolve. It would stimulate commitment and create incentives for regulatory, business, and stakeholder groups to work cooperatively in CSR standard-setting (eg CSR information-assessing, decision-making, and reporting guidelines for directors, through amplification of the ASX CGC principles and recommendations).[119] It would also allow the government to coordinate CSR expertise and guidance within government that is needed across various portfolios domestically and internationally, including material to inform Australia’s response to various ongoing CSR-related standard-setting initiatives internationally (eg the human rights responsibilities of transnational corporations, environmental and sustainability governance, global warming, public-private sector cooperation in solving worldwide problems etc).

A phase-by-phase and multi-pronged approach is best. In the first phase, the Government should commit itself to CSR as a matter of policy, and develop an overall framework for promoting CSR outcomes across the public, private, and not-for-profit sectors. Everything else outlined here is contingent upon this first phase. Here, the various policy commitments, governance mechanisms (eg Ministers for CSR, and parliamentary CSR reference groups), networking and partnering initiatives, regulatory and taxation support, government-centred CSR promotion (eg procurement and sustainable development), CSR-sensitive reform of corporate law, and other standard-setting on CSR that the UK Government is introducing all provide a model point of comparison and guidance on governmental levels of responsibility and initiative concerning CSR regulatory and policy reform.

Such a policy framework might even contain desirable CSR performance benchmarks.[120] It would enable the government to set desirable CSR indicators to benefit the Australian community as a whole, with a measured menu of both regulated and voluntary initiatives. It would combine ‘top down’ and ‘bottom up’ progress towards CSR solutions, and a blend of mandatory regulation, self-regulation, and co-regulation. It would provide an opportunity for the development and testing of more comprehensive evidence of CSR performance, needs, and impact than we have available now for evidence-based policy reform in this area.

The third matter in CAMAC's CSR Terms of Reference is wide enough to permit CAMAC to recommend that the Federal Government develops a comprehensive CSR policy framework of the kind developed by the UK Government. This framework would provide the structure for integrating and embedding CSR within mandatory corporate duties, voluntary corporate initiatives, and corporate reporting amongst other things. Government has a significant and different role from business in meeting CSR-related international obligations of nations, assisting companies and their investors to gauge CSR effects upon corporate and industry competitiveness, promoting ecologically sustainable development and business strategies, developing and facilitating CSR-based taxation incentives and other regulatory incentives,[121] facilitating CSR partnerships and networks, promoting CSR outcomes within government procurement and departmental operations, and setting an overall framework, agenda, and set of key indicators for CSR outcomes for the greater well-being of the community.[122]

Directors' Entitlement or Obligation to Take Account of Stakeholder Interests

Although some clarification and change is needed on directors' duties and correlative defences, too much change should not be introduced all at once, especially since the changes introduced in later phases will be shaped by what happens in earlier phases, as will commitment to successful reform at the outset. A 'phased in' approach is best, for a number of reasons. Moving immediately to a UK-style change to directors' duties to make directors have to consider designated non-shareholder interests is not the ideal first step, but should be incorporated in later phases.[123] As a first step, it introduces too dramatic a change to directors' duties and practices too quickly. It mandates something without the advance safety net of cooperatively developed guidelines for implementing its demands upon directors. Evidence-based policy reform concerning it needs more steps before its introduction in later phases. The appropriate first step is legislative clarification and encouragement of directors' capacity to take account of non-shareholder interests, supported by the related measures suggested here.

In terms of directors' duties (ie the focus of the first and second matters in CAMAC's Terms of Reference), any legislative clarification or change needs to be structured and drafted to cover five distinct elements. Putting important matters of form aside (such as whether any entitlement or obligation to consider non-shareholder interests is built into existing statutory directors' duties or added separately to them), those five distinct elements are: (i) the formulation of the entitlement or obligation to consider non-shareholder interests; (ii) identification of the entities to which this entitlement or obligation applies (eg all organizations, all corporations, or large publicly listed companies); (iii) identification of the circumstances in which the entitlement or obligation applies (eg generally, or only to particular kinds of decisions); (iv) the specified non-shareholder interests that can or should be considered; and (v) the decision-making framework and factors for considering those interests.

Here, the law of directors' duties should be legislatively clarified to confirm that directors can consider specified stakeholder interests in meeting their duties to the corporation.

Those duties should remain duties to the corporation. Both section 180 (ie the duty of care and diligence) and section 181 (ie the duty of good faith) of the Corporations Act make reference to 'the best interests of the corporation', for good reason. This formulation should be retained. In particular, neither the existing statutory directors' duties nor any entitlement or obligation of directors to consider non-shareholder interests should be recast in terms of the UK legislative proposal to frame directors' duties in terms of promoting the success of the company for the benefit of its members, for the reasons given throughout this submission. This is not because shareholder primacy needs diluting in favour of non-shareholders, but because of concerns about the explanatory and guiding capacity of an instruction to manage corporations for shareholders as a whole, as well as concerns about how narrowly and incompletely such conceptions of corporate responsibility have been interpreted in the past. However, other aspects of the UK proposal still offer a useful model for Australian comparison and customized adaptation.

Supplemental legislative guidance on the decision-making framework for considering both shareholder and non-shareholder interests could be considered, of the kind discussed here. The 'business judgment' defence should be clarified to encompass due consideration of specified stakeholder interests by directors. That might also mean considering extension of the 'business judgment' rule to other directors' duties too.[124]

The statutory formulation of this permissive requirement should include the best elements of the UK directors' duties proposal and US constituency statutes, while avoiding their deficiencies, but it should be structured in a way that clearly distinguishes between the range of shareholder and non-shareholder interests for directors to consider, on one hand, and the factors that are relevant in considering those interests, on the other, in the way outlined below.

Despite any misgivings about stakeholder pluralism and the problems of adequately defining all stakeholders whose interests could be considered by directors, on any account of key stakeholder interests there are groups of interests that clearly deserve inclusion, perhaps with a catch-all provision at the end for any other non-shareholder interests that relate to the company's success. The key interests to be listed include: the interests of shareholders; the interests of employees; those with business relationships with companies (eg suppliers and distributors); those who use company products and services (eg consumers and customers); those who provide finance or credit to companies (eg banks, financiers, credit providers, and other creditors); and the communities, society, and environment that are affected by a company. An entitlement (or even duty) to consider a particular set of interests in terms of their relationship to a company's success is different from a duty to act in the interests of a particular set or to give effect to their interests.

Having identified the relevant interests for consideration, the statutory formulation then needs to address the decision-making factors in considering those interests. This is one area where the special prominence and role of shareholders as investors can be specified. Building upon the features suggested in comparable legislative models and academic discussions, the decision-making framework for consideration of different shareholder and stakeholder interests might include some or all of the following factors:

(1) the immediate, near-term, and long-term consequences of corporate decisions and activities;
(2) the sustainability of the company and its ongoing success;[125]
(3) the need for a fair and proper return to shareholders for their investment in the company;
(4) the need for due consideration and treatment of all interests in the corporate constituency (however defined), according to their relationship to the company's success (including the need for members to be treated 'fairly', according to their particular rights of membership);
(5) the establishment and nourishing of essential business, credit, and employment relationships, including appropriate investment in employee education and training;
(6) the need to comply with corporate regulatory requirements as a necessary but not sufficient condition for achieving corporate success, and the interdependence between interests within the corporate constituency in meeting both of these conditions for corporate success;
(7) the need for stakeholder-sensitive elements that are relevant to a company's success to be embedded within the company's ordinary decision-making and other frameworks, processes, and procedures for – amongst other things – risk management, operational reviews, strategy, and reporting;
(8) the importance of a company's reputation for certain values (eg product and service quality, business ethics, customer satisfaction, fair pricing, and other CSR-related values) to its competitiveness and success;
(9) the desirability of minimizing or eliminating avoidable adverse effects of the company's activities and decisions upon local communities, the environment, and society generally; and
(10) the appropriateness of particular kinds of corporate contributions to society's governance and prosperity, including contributions of socio-economic, environmental, and 'free enterprise' benefit.[126]

Done in a way that addresses the issues and avoids the pitfalls flagged here, a legislative entitlement for directors to consider shareholder and stakeholder interests within a broad framework of decision-making considerations will clarify and enhance existing law. While most directors of business corporations would probably prefer that such an entitlement never becomes an obligation, at least some of them are likely to base that view on fears about expanded liability or diffuse responsibility that can be addressed in ways other than simply opposing such an obligation outright. In addition, there are policy reasons why that obligation should be introduced within, say, three years of the equivalent entitlement coming into effect. Indeed, business has to assess whether opposition to such an obligation might eventually amount to cutting off its nose to spite its face.

Here are some of the policy reasons in favour of the delayed introduction of such an obligation. First, on the analysis and arguments presented here, its introduction is predicated on the establishment of a governmental policy framework for CSR standard-setting and outcomes, along the lines of the UK model. Secondly, the introduction of such an obligation legally gives effect to what many in business claim is sound business practice – namely, that a successful business must take account of both shareholder and stakeholder interests. Business might respond that this does not mean that it should be exposed to legal consequences for not doing this, but that takes the issue towards enforcement and remedies, which can be handled in ways that dissolve business' worst fears. Thirdly, simply entitling directors to consider stakeholder interests works no real change in the current legal position, and can lead to the anomaly of companies of similar sizes in similar sectors making different decisions about whether and how to take non-shareholder interests into account without defensible and transparent justifications for such differences in approach.

Fourthly, its delayed introduction enables the government to put business and the community 'on notice' about the contemporary importance of CSR as a policy objective, allows time for more evidence-based consideration of CSR policy reform, gives business an opportunity to orient itself to this, and provides opportunities, incentives, and time for regulators, business, and the community to work together in developing suitable regulatory guidelines for meeting and reporting on this obligation. In particular, it would prevent too much change being sprung upon big business too soon, at a time when big business has not really been on notice from the current government to lift its game on CSR, and when internationally accepted CSR standards are at a critical stage in their evolution. It would give regulators, big business, and the stakeholder community a rationale, incentive, and timeframe for working together in developing adequate guidance for stakeholder-sensitive board decision-making (and CSR reporting), in a way that has not happened until now.

Fifthly, if the UK passes the Company Law Reform Bill in the form recommended through the Company Law Review and introduced into the UK parliament in late 2005, Australia and the UK would then be world standard-setters in legal obligations of directors to consider stakeholder interests. Given the clear shareholder-dominant orientation of the UK proposal, an obligation to consider non-shareholder interests hardly threatens the fabric of corporate law. Some business leaders and advisers might regard it as unnecessary, but that goes to a different point.

Sixthly, any reasonable concerns about dilution of shareholder primacy or enhancement of directors' exposure to stakeholder liability can be addressed in other ways (see below). Seventhly, in terms of policy trade-offs, such an obligation forestalls more radical reforms such as an obligation to give effect to stakeholder outcomes or other de-centring of shareholder primacy in corporate law. Eighthly, the introduction of such an obligation also requires the corresponding introduction of a 'business judgment'-like defence for decisions based on fulfilling such an obligation. Given the integral nature of such an obligation to corporate decision-making, business would be justified in seeking such a defence for more than just breaches of the statutory duty of care and diligence.

Finally, as an obligation simply to take account of designated interests is not an obligation to decide in favour of those interests, it does not inherently or inevitably create a new claim-right for stakeholders based on desirable stakeholder outcomes. It potentially paves the way for non-shareholders to complain about inadequacies in the process of consideration.[127] Ancillary measures can be devised to address the twin fears of increased stakeholder litigation based on inadequate consideration of non-shareholder interests, and decreased shareholder protection. To avoid the specter of endless claims by non-shareholders that directors have not given their interests due attention, consideration might be given to making breaches of directors' duties and other actions based upon such lack of attention actionable only where the failure to give due consideration results in demonstrable adverse consequences for both shareholder and non-shareholder interests within the corporate constituency. That way, directors are exposed to no greater chance of liability than when there is an actionable failure concerning shareholder interests.

While the potential is there for 'due process' claims based on no or inadequate consideration of stakeholder interests, those closely associated with the UK Steering Group do not seem to hold great fears about this possibility:[128]

> It is true that the new requirement to take into account stakeholder interests in deciding what will promote the company's success is formulated partly in an objective way: where relevant such matters must be taken into account, subject to a reasonably practicable defence. In theory, therefore, there is opened up a new avenue of attack on directors' decisions, ie that although the decision was taken in subjective good faith, the directors did not take account of all relevant considerations. My guess, however, is that British judges will not use this opportunity to develop public-law like controls on the exercise by directors of their discretion and certainly the CLR's strategy did not depend upon their so doing – or even wish to encourage them to do so. Rather the enforcement message which the CLR envisaged as likely to have main impact in practice was disclosure via the OFR, plus action taken on the basis of that disclosure.

The conventional arguments against legislatively creating an obligation of directors to take account of stakeholder interests are as follows. It is unnecessary, because the law already permits sufficient reference by directors to non-shareholder interests in making decisions about company interests. It is inappropriate, because real protection of social and environmental interests from harm should be through specific legislation targeting that protection. It is pointless, because it cannot effectively be enforced or the subject of an appropriate remedy by an appropriate party. It is counter-productive, because it waters down protection of shareholder interests without producing real benefit to non-shareholder interests. It is incoherent, because treating non-shareholder and shareholder interests fairly and balancing their competing demands is incapable of meaningful resolution by directors or anyone else. It is unwieldy, because any kind of obligation towards anyone other than shareholders is philosophically, conceptually, and doctrinally unsound. It is impractical, because there is no manageable way for directors to balance shareholder and other stakeholder interests. It is dysfunctional, as it turns corporations away from their core business and towards government's business of social governance. It is unfair, as it places burdens of social responsibility upon corporations that are not also placed upon individuals and other legal entities. It is short-sighted, because it makes the corporate regulatory burden and exposure to liability potentially greater for directors in Australia than in other jurisdictions, thus acting as a disincentive for investment here.[129]

This is one of the hardest judgment calls for CAMAC (and the PJCCFS). Good arguments exist on both sides. Frankly, my preliminary views have swung both ways at different stages in writing this submission. On balance, I favour the delayed and limited form of obligation canvassed here, with all of its outlined preconditions and safeguards. In case there is any doubt, I would not recommend its introduction unless those supporting features are also present.

Corporate Reporting

In terms of reporting, the policy objective is to ensure timely, trustworthy, and meaningful information for the intended audiences. Four things should happen in the first phase concerning CSR reporting. First, the ASX CGC should continue and enhance its ongoing monitoring and further development of its corporate governance principles and recommendations, with a renewed emphasis upon those of special relevance to CSR, especially Principle 3 (‘Promote ethical and responsible decision-making’), Principle 5 (‘Make timely and balanced disclosure’), Principle 7 (‘Recognise and manage risk’), and – most importantly – Principle 10 (‘Recognise the legitimate interests of stakeholders’). This should also be linked to guidance on consideration of stakeholder interests under the clarified and permissive directors’ entitlement to consider them under directors’ duties.

Secondly, consideration could also be given to giving ASIC a complementary or coordinating role here in developing in this area the kind of guidance about due consideration of the kind of socio-economic, ethical, and environmental concerns surrounding stakeholder interests that ASIC is legislatively authorized to provide in the realm of investment product disclosure statements.

Thirdly, CSR elements could be embedded further within existing reporting requirements, including the annual directors’ report on a company’s operations, financial position, and strategic prospects. As some of the submissions to the parallel PJCCFS inquiry suggest, corporations could perhaps be given some control and leeway in deciding whether and how CSR-related information should be reported and publicized through published directors’ reports, company reports, company websites, voluntary company social/CSR reports, or other means.

Fourthly, instead of an obligation to report or practice CSR in a minimum of key ways from the outset, in the first phase of reform there could be an obligation upon at least all large publicly listed corporations to disclose whether they purport to be socially responsible or not and, if so, in what ways. As part of this, any corporation that voluntarily makes claims about its social responsibility should be required to justify those claims by credible means beyond simply self-statement (eg demonstrated compliance with independent CSR standards, verification by independent expert report or report by non-aligned rating body, vetting by stakeholder advisory body, compliance with published CSR-centred guidance from the ASX CGC and ASIC etc).[130]

In the current climate, it is in the interest of stakeholders such as existing and potential investors, other members of corporate constituencies, and the public and regulators to know something as fundamental as whether or not a company purports to be socially responsible or not. The response, 'It depends on what you mean by socially responsible', can be met by specifying a limited set of key or minimum kinds of social/CSR areas of reporting and activities (eg publishing social reports, participating in published CSR ratings, engaging in corporate philanthropy, making political donations, sponsoring or participating in issue-based advertising campaigns and lobbying, meeting at least the average performance for companies of that size and sector in some minimum designated key CSR areas of activity etc). All of this would be enhanced, of course, by an overall governmental policy framework for CSR applicable across government, business, and the community.

Companies would remain in control of the fundamental decision to be socially responsible or not, and of how any non-commitment to being socially responsible is explained and justified to investors and the public. This aids transparency. It covers information that is relevant for investors in making investment decisions. The additional response, 'This is not a real option because few companies could afford the adverse public, reputational, and other costs of not being willing to make such a declaration and stick to it', is itself revealing. Given the mounting evidence that some kind of CSR is more than a passing fad nationally and internationally, the widespread acknowledgement within the business community of the relationship between socially responsible conduct and business competitiveness, and the growing interest amongst individual and institutional investors in knowing about a company's stance on CSR and factoring that into their investment choices, some minimal reform is justified in the first phase. The quid pro quo for not immediately imposing additional and mandatory CSR reporting or other obligations across the board, and for giving business an enhanced opportunity to help in steering the direction of CSR reporting and other obligations from here, in cooperation with regulators and stakeholders, is minimum public disclosure and reporting of the existence of any commitment to being socially responsible, explanation of the company's position and special circumstances if it does not have such a commitment, and justification of any claims to being socially responsible.

While it is possible that this additional need to justify claims might overlap with some existing obligations to avoid public disclosure and reporting that is misleading or deceptive,[131] this need for truth and accuracy in making claims about a company being socially responsible could at least be expressly acknowledged officially, which would give it extra force. The possibilities of key or minimum areas of social/CSR reporting and activities could be left to companies and their industry sectors to decide or delegated to ASIC and/or the ASX CGC for standard-setting. In addition, companies that do not meet the sectoral or industry five-year average for voluntary social/CSR reporting and activities for companies of that size and nature could be asked to disclose and account for that. This would go some way towards alleviating the inequity of imposing extra obligations of claim-justification upon companies that purport to make CSR a priority while allowing those companies that make no such claims to hide under the public radar.

Again, any inequities of this for companies of particular sizes and natures in particular sectors can be alleviated by matching any disclosure obligation to the average for companies of those kinds, so that the norm for large publicly listed companies is not necessarily the norm for everyone.[132]

Simply requiring companies who make claims about being socially responsible to prove those claims is not the same as imposing an additional and general burden on all companies to engage in social/CSR reporting. Similarly, requiring companies to disclose and account for whether or not they make claims about being socially responsible is not the same as imposing an additional and general burden on all companies to make themselves socially responsible. 'Corporations do not have to make claims that they are furthering other [shareholder-related] values at the same time as long-term shareholder returns [but] if they do so to differentiate themselves from others and to attract capital (or avoid shareholder motions for reform) they should report on the achievement of those claims and the means by which we can substantiate them', according to the Griffith Submission to the parallel PJCCFS inquiry. Equally, asking companies to disclose how their practice or non-practice of CSR (however defined for this purpose) matches their industry or sectoral average promotes transparency and provides information of value to investors, arguably without adding too much to the existing reporting burden on business, especially if the other reporting burden trade-offs outlined here are factored into the equation.

In terms of reporting, the introduction of enhanced CSR reporting could be undertaken on the basis that the overall level and burden of reporting is to remain roughly the same, with some areas of reporting being modified or streamlined to accommodate any increase in CSR reporting. In the field of corporate reporting, 'more' does not always mean 'better', and 'less' is sometimes 'more', at least where reporting is honed in ways to make the volume and type of reported information more meaningful to shareholders and non-shareholders alike. While Australia's system of continuous disclosure and reporting is good, there are credible arguments that we do not yet have the balance right on the range, specificity, and usefulness of reporting for its intended audiences. In this way, CSR reporting reform could also provide the occasion for improvements to the wider corporate reporting regime. Instead of being viewed as additional regulation and extra costs imposed by government, such things can also viewed as means by which business improves its information base and expertise for assessing the risks and responding to the opportunities stemming from the interaction of socio-economic, environmental, and ethical concerns with business matters.[133]

Conclusion

In one sense, the broad policy choices open to CAMAC and the government boil down to a few basic choices. Is CSR reform of some kind desirable or not? Do we need a menu of regulatory, co-regulatory, and self-regulatory measures to improve CSR within Australia? Do we introduce CSR reforms progressively or all in one hit, with opportunities for testing and input by all affected regulatory communities (including regulators themselves) along the way? What needs to be done in the five key areas of legislative clarification of directors' duties, legislative enhancement of directors' duties, regulatory and business embedding of CSR within ordinary corporate strategizing and risk assessment, enhancement of meaningful CSR reporting, and governmental CSR policy frameworks? If CAMAC (and the equivalent PJCCFS inquiry) recommend no changes of the right kinds to corporate obligations, directors' duties, and company reporting, that will go down in history not only as a missed opportunity for better CSR in its own right, but also as a missed opportunity for Australia to become a world leader in developing co-operative best practice on CSR.

[1] While Professor Horrigan is also a long-standing consultant to a leading national law firm, this submission is undertaken in a personal and academic capacity alone.

[2] B. Horrigan, 'Corporate Social Responsibilities, Directors' Duties, and the Anglo-Australian Reform Landscape', *Reform*, (Australian Law Reform Commission's journal), Issue 87, Summer 2005-06; B. Horrigan, 'Cleaning Up Their Act?: Current Government Inquiries', *Precedent* (Australian Lawyers' Alliance's journal), Issue 70, September-October 2005, pages 10-15; and B. Horrigan, 'Update on the Australian Government's Corporate Social Responsibility Inquiries', CCH *Australian Corporate News*, Issue 23, 6 December 2005, pages 276-281.

[3] B. Horrigan, 'Comparative Corporate Governance Developments – Key Ongoing Challenges from Anglo-American Perspectives' in Tully, S. (ed.), *Research Handbook on Corporate Legal Responsibility*, Edward Elgar Publishing Ltd, Cheltenham, pages 20-53 ('Horrigan, 2005'); and B. Horrigan, 'Fault Lines in the Intersection Between Corporate Governance and Social Responsibility' (2002) 25 *UNSW Law Journal* 515 ('Horrigan, 2002').

[4] Throughout, I refer to shareholders and non-shareholders constituting one corporate constituency, rather than separate corporate constituencies, largely for the reasons that lead Eric Orts to adopt the same terminology in: E. Orts, 'Beyond Shareholders: Interpreting Corporate Constituency Statutes' (1992) 61:1 George Washington Law Review 14.

[5] On this issue, see the discussion in the DEST publication authored by the Council for the Humanities, Arts & Social Sciences ('CHASS'), *Measures of Quality and Impact of Publicly Funded Research in the Humanities, Arts and Social Sciences*, CHASS Occasional Paper 2, 2005.

[6] UK Hansard, House of Lords, 11 January 2006.

[7] Corporations Act, section 180(2).

[8] Eg Corporations Act, section 1318.

[9] For discussion of arguments about this in the context of US constituency statutes, see: E. Orts, 'Beyond Shareholders: Interpreting Corporate Constituency Statutes' (1992) 61:1 George Washington Law Review 14 (especially at 79-84). In the Australian context, one key question is the extent to which the elements of the 'business judgment' defence to breaches of the duty of care and diligence are conditioned by the prevailing 'shareholder primacy' orthodoxy, in a way that could be affected by enlarging directors' entitlement or obligation to consider non-shareholder interests. Do elements such as '[making] the judgment in good faith for a proper purpose' and 'rationally [believing] that the judgment is in the best interests of the corporation', for example, have their centre of gravity automatically altered by such legislative moves, in the absence of express legislative nullification of this particular effect?

[10] At face value, an entitlement or discretion to consider something does not automatically generate an obligation to consider it. However, the point and context of such consideration matters, as we are not talking about a simple or absolute discretion in its own right. If the primary obligation of directors is to act in the company's best interests, and in particular circumstances that outcome requires consideration of non-shareholder interests affecting the company, the contrary argument is that the primary obligation makes such consideration necessary as part of fulfilling the duty.

[11] This is why it is important to keep in mind the distinction between considering non-shareholder interests at large and for their own sake, on one hand, and considering them as part of the corporate constituency and through the prism of how they relate to the corporation's interests, on the other. Delineating why these interests account and for what purpose shows that no such claim-right necessarily vests in non-shareholders, although that is itself a matter for legislative attention in any tidying up or reform of the law.

Of course, non-shareholders might have related remedies, such as an opportunity to take advance action protecting their interests from real harm by means of seeking an injunction against the company under section 1324 of the Corporations Act, but that would be because of the non-shareholders coming within the terms of section 1324's elements, and not because of any free-standing right of theirs to have their interests as non-shareholders considered before a company acts.

[12] The 1989 Senate Committee Report concludes (in para [6.44]): 'If directors were permitted to take "outside" interests into account …, 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.' This is correct in its application to a specific legislative provision not only permitting directors to consider non-shareholder interests but also excusing any non-consideration from amounting to a breach of directors' duties. That is a different question from the position under the current law, in the absence of such legislative clarification. Admittedly, it is hard to conceive of ordinary situations under the current law in which a failure to consider non-shareholder interests alone could amount to a breach of a director's duty to act in the company's interests. However, whatever discretion might be involved in considering non-shareholder interests under the existing law, there is no discretion about acting in the company's interests, and it is the obligation to consider non-shareholder interests in circumstances where that is necessary to safeguard and advance the company's interests that might present difficulties. So, the question is whether this is a realistic and not just abstract exposure for directors and, if so, whether it needs legislative attention.

[13] Eg M. Kelly, *The Divine Right of Capital: Dethroning the Corporate Aristocracy*, 2001, Berrett-Koehler Publishers, San Francisco; J. Elkington, *Cannibals with Forks: The Triple Bottom Line of 21st Century Business*, 2002, Capstone Publishing, Oxford; S. Wheeler, *Corporations & The Third Way*, 2002, Hart Publishing, Oxford; S. Hilton and G. Gibbons, *Good Business: Your World Needs You*, Texere Publishing, London; L. Drutman and C. Cray, *The People's Business: Controlling Corporations and Restoring Democracy*, 2004, Berrett-Koehler Publishers, San Fransisco; S. Cooper, *Corporate Social Performance: A Stakeholder Approach*, 2004, Ashgate Publishing (UK); D. Crowther and L. Rayman-Bacchus, *Perspectives on Corporate Social Responsibility*, 2004, Ashgate Publishing (UK); S. Tully, ed, *Research Handbook on Corporate Legal Responsibility*, 2005, Edward Elgar Publishing Limited (UK); P. Kotler and N. Lee, *Corporate Social Responsibility: Doing the Most Good for Your Company and Your Cause*, 2005, John Wiley & Sons (New Jersey); C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*, 2005, Wharton School Publishing (New Jersey); C. Laszlo, *The Sustainable Company: How to Create Lasting Value Through Social and Environmental Performance*, 2005, Island Press, Washington; Y. Sheffi, *The Resilient Enterprise: Overcoming Vulnerability for Competitive Advantage*, 2005, The MIT Press, Cambridge (Mass); D. Daianu and R. Vranceanu, eds, *Ethical Boundaries of Capitalism*, 2005, Ashgate (UK); and B. Horrigan, *Corporate Social Responsibility in Action*, 2007 (forthcoming); Edward Elgar Publishing (UK).

[14] D. Wood, 'Whom Should Business Serve?' (2002) 12 Australian Journal of Corporate Law 266.

[15] D. Wood, 'Whom Should Business Serve?' (2002) 12 Australian Journal of Corporate Law 266 at 278-280 and 284-285.

[16] M. Kelly, *The Divine Right of Capital: Dethroning the Corporate Aristocracy*, 2001, Berrett-Koehler Publishers, San Francisco, at pp 146-148.

[17] This submission outline others reasons too for why taking account of non-shareholder interests might be mandated in some form, and the additional issues this raises in keeping corporate law in an acceptable state.

[18] In some cases, what lies behind this position is a real concern about something else other than having to consider non-shareholder interests (which many businesses and representative bodies say successful companies do anyway), such as a concern about the claim-rights potentially available to non-shareholders if this happened. That can be dealt with in other ways.

[19] M. Kelly, *The Divine Right of Capital: Dethroning the Corporate Aristocracy*, 2001, Berrett-Koehler Publishers, San Francisco, at p 150.

[20] Whatever 'maximise' actually means in this context. For both conceptual and operational critique of the notion of 'maximising' shareholder wealth, see: D. Wood, 'Whom Should Business Serve?' (2002) 12 Australian Journal of Corporate Law 266.

[21] See the comments and citations on this in: D. Wood, 'Whom Should Business Serve?' (2002) 12 Australian Journal of Corporate Law 266 at 280.

[22] Some submissions to the parallel PJCCFS inquiry raise these legitimate concerns, particularly the submission by the Australian Institute of Company Directors ('AICD Submission').

[23] L. Stout, 'On the Nature of Corporations' [2004] DeakinLRev 33; and M. Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century' (2003) 51 UCLA Law Review 387.

[24] This is reflected, for example, in the submission by the IEGL and KCELJG from Griffith University to the parallel PJCCFS inquiry ('Griffith Submission').

[25] This includes, but is not limited to, the 'business judgment' defence to the breach of the statutory duty of care and diligence under section 180(2) of the Corporations Act, as other provisions also have elements that turn on the commercial judgments of directors, such as whether or not to bring an action on behalf of the company. This point about multiple provisions and contexts raising issues about directors' business judgments is one that Professor Bob Baxt has emphasized in his writings. This is an important aspect of flow-on implications of any changes to directors' duties and 'business judgment' defences, which needs careful attention to ensure that any reforms do not have unintended or ill-considered consequences.

[26] Corporations Act, sections 128 and 129.

[27] Corporations Act, section 1318. This aspect is highlighted well in the AICD's submission to the parallel PJCCFS inquiry ('AICD Submission').

[28] Corporations Act, sections 236 and 237.

[29] Principles 3, 5, and 7 are also relevant to CSR.

[30] W. Beerworth, 'Corporate Social Responsibility Doesn't Come Easy', *Australian Financial Review*, 11 November 2005.

[31] If this failure to take adequate account of non-shareholder interests *as risks* is sufficient to justify removal of directors (as signaled in CAMAC's Discussion Paper), it must also raise questions about meeting applicable directors' duties and being able to rely upon 'business judgment' defences.

[32] This imbalance in standard-setting for financial and non-financial factors is due in part to the lack of serious attention given to standard-setting for non-financial factors until relatively recently. That is not a good reason not to reform the law to keep pace with this evolving need. As the footnoted sources and comments in CAMAC's Discussion Paper indicate, there is already considerable progress in this area. Contrary to the conventional wisdom that the public sector has much to learn from the private sector, this is one area where the private sector might learn some things from the public sector, which is more used to considering both financial and non-financial factors, give the public interests in play. For example, government business enterprises and statutory authorities are often required to include and report on non-financial matters, such as including community service obligations ('CSOs') in their corporate plans and including reference to both their financial and non-financial performance in annual reporting. However, to the extent that any aspects of public sector accounting, auditing, and reporting track and customize standard-setting in the private sector, this problem of inadequate standard-setting for the private sector affects the public sector too.

[33] For further discussion, see the references and arguments cited in Horrigan, 2002 and Horrigan, 2005.

[34] D. Baron, *Business and Its Environment*, 5th ed, 2006, Pearson Education, New Jersey, at p 654.

[35] D. Wood, 'Whom Should Business Serve?' (2002) 14 Australian Journal of Corporate Law 266.

[36] Eg Professor Ronald Dworkin's famous distinction between legal 'rules' and 'principles' as matters for consideration by judges, and socio-economic 'policy' goals as a matter for consideration by legislators.

[37] Other examples of CSR-related aspects already embedded in Australian corporate regulation are detailed in Griffith University's submission to the PJCCFS inquiry ('Griffith Submission').

[38] I. Ramsay, 'Reform Rush Would Be Unwise', *The Australian Financial Review*, 10 February 2005.

[39] The nuances here are important. Much of the anti-CSR reaction is driven by fears that directors will lose focus and shareholders will suffer financially if directors give effect to non-shareholder interests in their own right, but that is not what such an entitlement or even an obligation along these lines would do.

[40] One additional problem here is that provisions like the statutory 'business judgment' defence to a breach of the duty of care and diligence have been drafted mainly with shareholder-focused concerns in mind. How, for example, does someone show that they have met all of the preconditions for reliance upon this defence when the issue is the extent to which they have informed themselves about and then properly assessed relevant non-shareholder interests and their interplay with shareholder interests, in the overall balance of deciding what is best for the company?

[41] See, especially, paragraph [6.42].

[42] I. Ramsay, 'Reform Rush Would Be Unwise', *The Australian Financial Review*, 10 February 2005.

[43] Quoted in M. Kelly, *The Divine Right of Capital: Dethroning the Corporate Aristocracy*, 2001, Berrett-Koehler Publishers, San Francisco, at p 150.

[44] J. McConvill, 'Directors' Duties to Stakeholders: A Reform Proposal Based on Three False Assumptions' (2005) 18:1 Australian Journal of Corporate Law 88.

[45] I. Ramsay, 'Public Show and Tell is the Way to Incentivise Directors and Their Companies to Behave Nicely' *The Age*, 21 July 2005.

[46] M. Hellicar, 'Managing Corporate Social Responsibility', Monash University Governance research Unit Workshop on the Social Responsibility of Company Directors, 2005, Melbourne. This submission's author is a consultant for a firm that has done legal work for the James Hardie group.

[47] W. Beerworth, 'Directors' Duties and Corporate Social Responsibility', Seminar paper, CAMAC and Centre for Corporate Law and Securities Regulation Seminar, 2005.

[48] Sperling, 2005: 88.

[49] Reported in Sperling, 2005: 88.

[50] Of course, compliance with the law can also be viewed as something ultimately of benefit to the company and its shareholders, given the benefit of avoiding the damage to the corporation's reputation, risk of liability, and other costs of non-compliance.

[51] See also: R. Baxt, 'Corporate Social Responsibility – Things Are Starting to Get Serious!', The Baxt Report, Vol 2, Issue 1, December 2005, at p 7.

[52] I. Ramsay, 'Reform Rush Would Be Unwise', *The Australian Financial Review*, 10 February 2005.

[53] Eg E. Cox, *A Truly Civil Society*, 1995 Boyer Lectures.

[54] Annan, 1999.

[55] Annan, 1999.

[56] BP's submission to the parallel PJCCFS inquiry ('BP Submission').

[57] Eg P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[58] D. Wood, 'Whom Should Business Serve?' (2002) 14 Australian Journal of Corporate Law 266.

[59] T. Dunfee, 'Do Firms with Unique Competencies for Rescuing Victims of Human Catastrophes Have Special Obligations? Corporate Responsibility and the AIDS Catastrophe in Sub-Saharan Africa', Working Paper, The Wharton School, Philadelphia, 2006 (to be published in (2006) 16: 2 Business Ethics Quarterly 185).

[60] Griffith Submission.

[61] D. Wood, 'Whom Should Business Serve?' (2002) 14 Australian Journal of Corporate Law 266.

[62] E. Orts, 'Beyond Shareholders: Interpreting Corporate Constituency Statutes' (1992) 61:1 George Washington Law Review 14 at 72-73 (original emphasis).

[63] Friedman, 1970.

[64] For discussion and authorities on a similar illustration, see: Horrigan, 2002.

65 Prahalad, 2005.

[66] M. Friedman, *Capitalism and Freedom*, 1962 (40th Anniversary Edition, 2002), University of Chicago Press, Chicago, at p 133.

[67] M. Friedman, *Capitalism and Freedom*, 1962 (40th Anniversary Edition, 2002), University of Chicago Press, Chicago, at p 133.

[68] M. Friedman, 'The Social Responsibility of Business is to Increase Its Profits', *New York Times Magazine*, 13 September 1970.

[69] Bush, 2002.

[70] M. Friedman, 'Making Philanthropy Out of Obscenity' (2005) 37:5 *Reason* 32.

[71] B. Horrigan, 'Corporate Social Responsibilities, Directors' Duties, and the Anglo-Australian Reform Landscape', *Reform*, (Australian Law Reform Commission's journal), Issue 87, Summer 2005-06.

72 Hansmann and Kraakman, 2000.

73 Hansmann, 2005.

74 Hansmann and Kraakman, 2004: 18.

75 Hansmann and Kraakman, 2004: 18.

76 Hansmann and Kraakman, 2004: 18.

77 Hansmann and Kraakman, 2004: 18.

78 Hansmann and Kraakman, 2004: 18.

79 Quoted in Simons et al, 2002.
80 Simons et al, 2002.
81 Business Roundtable, 1997.
82 Davis, 2005.
83 Davis, 2005.

[84] On some of these success components, see the discussion and references cited in D. Wood, 'Whom Should Business Serve?' (2002) 14 Australian Journal of Corporate Law 266, especially at 278.

[85] On modeling from one country to another in global business regulation, see: J. Braithwaite and P. Drahos, *Global Business Regulation*, 2000, Cambridge University Press, Cambridge.

[86] Griffith Submission.

[87] S. Bottomley, 'From Contractualism to Constitutionalism: A Framework for Corporate Governance' [1997] *SydLRev* 17.

[88] M. Blair and L. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia Law Review 247; and M. Blair and L. Stout, 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 Washington University Law Quarterly 403.

[89] On this discussion of 'shareholder values', see: Griffith PJCCFS Submission; and C. Sampford and V. Berry, 'Shareholder *Values* Not Shareholder Value' (2004) 13: 1 Griffith University Law Review 115.

[90] CAMAC, 2005: 71.

[91] On these points, see Orts, 1992: 16-25.

[92] S. Deakin, 'The Coming Transformation of Shareholder Value), Corporate Governance: An International Review, 13(1), January 2005, at pp 11-18.

[93] On these differences, see: D. Wood, 'Whom Should Business Serve?' (2002) 14 Australian Journal of Corporate Law 266.

[94] P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[95] P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[96] Griffith PJCCFS Submission.

[97] Griffith PJCCFS Submission.

[98] This last approach is my favoured one. It is a summary of the complex relationship between a corporation, its success, its corporate constituency, and the interplay between a corporation's constituency and contributions to its success.

[99] UK Hansard, House of Lords, 11 January 2006.

[100] P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[101] See BP's PJCCFS Submission.

[102] As commentators like Professor Bob Baxt indicate, there are more areas in Australia's Corporations Act involving elements of business judgments by directors than just the statutory 'business judgment' defence to a breach of the primary directors' duty of care and diligence.

[103] P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[104] Eg directors' annual reporting requirements going to such factors under the Corporations Act, section 299A.

[105] This submission is based on the form of the Bill discussed in the CAMAC Discussion Paper.

[106] On some of these criticisms, also see: I. Ramsay, 'Public Show and Tell is the Way to Incentivise Directors and Their Companies to Behave Nicely' *The Age*, 21 July 2005; and Mallesons Stephen Jacques, Submission to PJCCFS Inquiry into Corporate Responsibility, 2005.

[107] Rationales and suggestions concerning this aspect appear in the Griffith PJCCFS Submission.

[108] Eg Shann Turnbull's PJCCFS Submission.

[109] On the need for reform of corporate reporting requirements generally, see, for example, Shann Turnbull's Submission to the parallel PJCCFS inquiry ('Turnbull Submission').

[110] F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law*, 1991, Harvard University Press, Cambridge (Mass), at p 36.

[111] Mackey, 2005: 31.

112 Braithwaite and Drahos, 2000: 162, 173.

[113] Again, see the Griffith PJCCFS Submission on this point.

[114] Especially the third matter in CAMAC's Terms of Reference.

[115] Eg Prime Minister's Awards for Excellence in Community Business Partnerships, Australia's formal responses to drafts of CSR-related international agreements, government-business-community advisory bodies etc.

[116] Economic and taxation incentives, environmental and employment regulation, Australia's international obligations (eg the Australian Government's stance on the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights) etc.

[117] 'Corporate Social Responsibility – Things Are Starting to Get Serious', *The Baxt Report*, Vol 2, Issue 1, December 2005, at p 5.

[118] As reported in KPMG's 2005 international survey of CSR reporting, as discussed in: I. Ramsay, "Public Show and Tell is the Way to Incentivise Directors and Their Companies to Behave Nicely', *The Age*, 21 July 2005.

[119] This might require additional representation on the ASX CGC to capture relevant stakeholder representation and expertise. The ASX CGC emerged from the last CLERP reforms, whose corporate governance focus on disclosure and audit is not co-extensive with a CSR focus.

[120] Eg level of industry-specific or overall business spending on average on charity and philanthropy, level and range of voluntarily reported mechanisms for ensuring due consideration of stakeholder interests, increases in the reported commissioning of expert socio-economic impact analyses to inform business decision-making, increases in formal and informal involvement of stakeholders in corporate governance mechanisms, co-operative development of CSR regulatory guidance, level of industry-specific or overall business reporting on average on CSR activities and outcomes etc.

[121] Eg the UK Community Investment Tax Relief ('CITR') scheme.

[122] See, for example: *Corporate Social Responsibility: A Government Update*, UK Government (www.csr.gov.au).

[123] If, as many businesses already acknowledge, taking account of stakeholder interests already happens and is integral to successful corporate strategizing, 'risk and opportunity' assessment, and decision-making, the choice is between leaving this as a largely ad hoc, unguided, non-transparent, and discretionary matter for directors, or putting it on some firmer policy and regulatory footing (as in the UK proposal on directors' duties) without generating the kinds of problems most feared by the business sector (eg expansive claim-rights for stakeholder groups).

[124] Some submissions to the parallel PJCCFS inquiry suggest the same (eg AICD Submission), although sometimes for different reasons to those outlined here.

[125] While some commentators decry the hijacking of the term, 'sustainability', for use in a business context (as distinct from its use in the context of environmental sustainability), this simply highlights the need in both cases to clarify the sense of sustainability under discussion.

[126] This set of factors reflects, and sometimes extends beyond, factors that are listed in the UK statutory proposal on directors' duties and some US constituency statutes, as well as some factors discussed in D. Wood, 'Whom Should Business Serve?' (2002) 12 Australian Journal of Corporate Law 266 at 285.

[127] Having no comeback for inadequate consideration of non-shareholder interests creates the incongruity of a mandatory obligation without a correlative remedy.

[128] P. Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural WE Hearn Lecture, University of Melbourne Law School, 4 October 2005.

[129] Some of these arguments are drawn from submissions to the parallel PJCCFS inquiry. There are counter-responses available to some (if not all) of these arguments.

[130] Some PJCCFS submissions call for positive assertions of CSR claims by companies to be justified.

[131] Some PJCCFS submissions mention this point.

[132] For a similar proposal, see: T Dunfee, 'Do Firms with Unique Competencies for Rescuing Victims of Human Catastrophes Have Special Obligations? Corporate Responsibility and the AIDS Catastrophe in Sub-Saharan Africa', Working Paper, The Wharton School, Philadelphia, 2006 (to be published in (2006) 16: 2 Business Ethics Quarterly 185).

[133] Some submissions to the parallel PJCCFS inquiry (eg Griffith Submission) make similar points about framing the positive aspects of this for business.

Corporate social responsibility and the best interest of the company

Submitted by: Tabitha Ponnambalam

During the CLERP 9 Parliamentary debates, the government, the opposition, and the Democrats agreed to changes that made directors of corporate boards more accountable. Not surprisingly, the opposition and the Democrats were of the opinion the government was not going far enough in regulating the actions and the accountability of directors.

The current discussion considers the appropriateness and wisdom of requiring the directors of a corporation to consider its social responsibilities over and above the traditional and rather narrower concept of the best interest of the corporation.

Directors of a company have long been required to act in the best interest of the company: *Percival v Wright [1902] 2Ch 421; Southern Cross Mine Management v Ensham Resources (2004) 22 ACLC 724.* One well-recognised exception is where a company is insolvent; then, directors are also required to consider the interests of the corporation's creditors: *Re Martco Engineering Pty Ltd (1999) 32 ACSR 487; Re Spedley Holdings (in liq); Re Aldershot (in liq) (1992) 10 ACLC 1,742.*

In this day and age is it appropriate for directors to act only in the best interest of the company? Is it necessary to draw a distinction between the duties of directors of small and medium sized companies and those of directors of large companies? Should the directors of large companies be required not only to act in the best interest of the company and its shareholders, but also to consider and act in the interests of its employees and the public interest in general?

When HIH collapsed the government used its funds, or more precisely public funds, to bailout the policyholders of a private company. Similarly, with the collapse of Ansett Airlines the government stepped in with public funds to assist employees with some of their lost employee entitlements. Even the bastion of free enterprise, the United States, has in the past used taxpayer funds to rescue corporate enterprises by bailing out

Chrysler and United Airlines. The fact that governments have deemed it appropriate to bailout private corporations is surely recognition by government of the public interests involved in rescuing or supporting large private enterprises, or at least in ameliorating the harmful effects of their failure. At present times, the idea that it is appropriate for directors of large companies to act only in the best interest of the company appears increasingly outmoded.

The modern corporation is a very different entity from that which was first envisaged under the first Companies Act of the 1860s. The collapse of a mega- modern corporation can have huge economic and social implications; the thousands of employees, shareholders and policyholders hurt by the collapse of HIH and Ansett are but recent examples. The collapse of some of these mega corporations can help bring down governments as happened in Western Australia and Victoria in the early 1990s. Is it not time to give recognition to employee interests when the boards of these corporations make their decisions? It is not suggested that the employee interests be the primary interest, but certainly as important participants whose interests are at stake they ought to be considered.

The largest companies in Australia invariably have employee share plans. Thus making employees also shareholders. In view of this, requiring directors to also consider the interests of employees when considering the best interest of the company is a proposal or step worth considering. In the early 1990s, when Westpac ran into difficulties and its commercial viability and solvency was threatened, Westpac relied on its employee pension funds to help work itself out of its difficulties.

The issue is whether it is appropriate or realistic for the directors of these large corporations to not take into consideration the interests of employees, who are also invariably shareholders, when purporting to act in the best interest of the company?

Civil and criminal penalties for corporate breaches

Since the early 1990s more and more civil penalties and criminal sanctions have been imposed for a breach of the Corporations laws. Criminal sanctions were historically reserved as sanctions for a breach of the public interest or of public laws. Civil remedies existed for a breach of civil wrongs between parties. The relatively recent imposition of civil penalties and criminal sanctions for a breach of the Corporations laws is surely recognition of the public interest in regulating the actions of those running these corporations, or of a public duty on the part of those running the affairs of the modern corporation.

In view of this modern trend to recognise the public interest or public duty on the part of those running the large modern corporation, is it not time for us to be realistic about the public duty and/ or public interest as stake and require the board to also consider these interests in making their decisions for and on behalf of the modern corporation?

Formal recognition of employee interests and the public interest may help reduce the problems faced by public corporations with dominant personalities at the helm. These dominant personalities tend to run these corporations as their personal fiefdoms, despite the fact that they are utilising public shareholder funds. HIH insurance was a public company, which could not distinguish the corporation’s interests from that of its founder Ray Williams. Bernie Ebbers, the founder and former CEO of Worldcom, too could not dissociate his interests from that of the company, as was the case with Ken Lay and Enron.

German corporate governance code

The German corporate governance code provides an alternative model for corporate governance. We have in the past been willing to learn from the Civil law countries. Our system of Torrens title registration was based on the Austrian system of land registration. We should be willing to be open to new ideas and ways of dealing with changing circumstances.

The corporate governance principles for a German corporation are set forth in the German Stock Corporation Act (Aktiengesetz), the German Co-Determination Act (Mibestimmungsgesetz) and the German Corporate Governance Code (Deutscher Corporate Governance Kodex, as amended in May 2003).

A German corporation is required to have a dual board system: a supervisory board and a management board. The two boards are separate and no one can serve on both boards simultaneously. The supervisory board appoints, advises, supervises and dismisses the members of the management board. Fundamental decisions of policy are the responsibility of the supervisory board. The management board is responsible for the day-to-day management of the company. The directors of both boards owe a duty of care and loyalty to the company, and are supposed to act in the interest of the company. The chairman of each board is responsible for coordinating the work of their respective boards.

Shareholders at the general meeting elect the members of the supervisory board. Employee representatives are entitled to one third of the supervisory board positions on corporations with more than 500 employees in Germany, and to half the supervisory board positions on corporations with more than 2000 employees in Germany. The chairman of the supervisory board with more than 2000 employees is usually a representative of the shareholders and has a casting, or deciding, vote on important resolutions. However, both the employee representatives and the shareholder representatives on the board are expected to act in the corporation's interests.

The dual board structure is common in Europe, although having employee representatives on the supervisory board does not appear to be that common. Yet, this dual board system with employees serving on the supervisory board seems to have worked for the German corporations. The large German corporations such as Volkswagen AG, BASF AG, Bayer AG, Allianz AG, seem to have been able to operate effectively with at least 50% of their supervisory board positions reserved for employees. For instance, the BASF supervisory board has 10 shareholder representatives and 10 employee representatives, as does the supervisory board of Allianz AG and Bayer AG.

An article in the *Economist* credits the rapid economic development of Germany after the destruction of World War II to having employees on the boards of these large corporations. At the same time, it holds the employee representatives on these boards as being responsible for the delay in making some fundamental and necessary changes to German Labour laws in modern times: *Economist - "How to pep up Germany's economy"*, 6 May 2004. In view of this criticism, it is recommended that consideration be given to reserving only 25% of board positions for employees of the large or mega-modern corporation.

The way forward

The German dual board structure can be seen as having some similarities to our corporate law system in that, usually, we have an executive management team that is responsible for the day to day running of the company. However, our corporate law system does not give the executive management team the formal recognition that the German management board appears to have under German law. It is not suggested that we implement a dual board structure, only that we consider having employee representation on the boards of large corporations employing over 500 employees. This concept is not entirely new in Australia, some of our statutory corporations such as the *Australian Broadcasting Corporation Act 1983* authorises the election of a staff elected director to the board of the ABC.

It is submitted that having employee representation on the board is a realistic recognition of the employees' interest in the continued success and viability of the large modern corporation. At present times, when most large corporations have employee share plans, which are also recognition of an employees' interest in the corporation, is it not time to more formally recognise the employees' interest in the corporation?

In conclusion, it is suggested that:

- the Corporations Act be amended to draw a distinction between the duties and responsibilities of directors of small or medium sized companies and those of large companies because of the greater public interests at stake with respect to the large or mega-modern corporation;
- we formally recognise that while those running our large public corporations must act in the best interests of the corporation, that this requires the board of directors to consider not only the interests of the shareholders, but also the interests of the employees, and also the greater public interest in general such as economic and environmental matters;
- the corporation's social responsibility must be directly commensurate and correspond to the corporation's power, wealth and influence; and finally,
- with respect to the large modern corporation that we consider reserving a quarter of the board positions for employee representatives, a quarter for management representatives and half for shareholder representatives.

Submitted by: Tabitha Ponnambalam LLB, LLM, MBA
Solicitor
tponnambalam@bigpond.com
Mobile: 0438 234 823

Australian Human Rights Centre
www.ahrcentre.org

Justine Nolan
Faculty of Law
University of NSW
Sydney, Australia
Justine.nolan@unsw.edu.au
Tel: +61 2 9385-2863
Fax: +61 2 9385-1175

23 February, 2006

Corporations and Markets
Advisory Committee
GPO Box 3967
Sydney NSW 2001
(via email)

Dear Sir,

Response to CAMAC's Corporate Social Responsibility Discussion Paper (Nov. 2005)

This submission primarily relates to the issue of whether the *Corporations Act* should require certain types of companies to report on the social and environmental impact of their activities ((Issue 4.8, CAMAC, Corporate Social Responsibility Discussion Paper, November 2005).*

1. Executive Summary

The growth and interest in corporate responsibility issues has in part stemmed from recurring examples of corporate irresponsibility which, while not new, are perhaps better publicized in the modern era. Voluntary efforts, have to date, been the overwhelming mechanism chosen to ensure that companies assume appropriate responsibility and transparency for various human rights and environmental obligations. But such voluntary efforts can serve as precursors to binding formal rules and the emerging public reporting requirements of companies in select jurisdictions – mandating variations of triple bottom line reporting - indicate a willingness of some regulatory agencies to adopt a more expansive modern view of what issues are considered material to a corporation's short and long term performance.

It is indisputable that the idea of corporate responsibility is becoming increasingly important to both domestic and transnational corporations but unless and until it is effectively integrated as a core concept within a company it will not be taken seriously. The primary role of the directors will always be to promote the success of the company but it is now the duty of directors to recognize (and be required to recognize) that success is more likely when the board takes a broad view of all the factors that influence such success. This is determined by consideration of factors such as the impact of social and environmental issues on a company's stakeholders, not just its shareholders. The focus of this paper is on examining the value and effectiveness of corporate public reporting - to whom, what and when should 'social and environmental' issues be disclosed – as a means of institutionalizing corporate responsible behaviour. The paper concludes that mandating the disclosure of social and environmental issues is a necessary step in integrating corporate responsibility issues as part of a company's core business strategies. Clear guidance must be provided to companies on what and when such issues should be disclosed or triple bottom line reporting runs the risk of engendering a movement that merely encourages the production of token reports that lack consistency, comparability and credibility.

2. Introduction

i. Overview of corporate responsibility

Corporate responsibility, corporate social responsibility, corporate accountability or corporate citizenship, however termed, is not a new concept but lacks a commonly agreed definition. The World Business Council for Sustainable Development defines it rather abstractly as "the commitment of business to contribute to sustainable economic development, working with their employees, their families, the local community and society at large to improve their quality of life".[1] Business for Social Responsibility, a U.S. based organization interprets corporate social responsibility as a means of addressing the legal, ethical, commercial and other expectations society has for business, and making decisions that fairly balance the claims of all key stakeholders.[2] The key features of many definitions tend to be a focus on the long term impact of corporate practices and the principle that organisations owe an obligation to a broader set of stakeholders, beyond simply shareholders. The lack of

* This submission is based on an earlier submission by the author to the Parliamentary Joint Committee on Corporations and Financial Services in September 2005. The only distinction between the two submissions is the updated references to the recent decision by the United Kingdom to abandon the statutory requirement for companies to produce an Operating and Financial Review. This decision is currently under legal challenge. See: http://business.guardian.co.uk/story/0,,1684262,00.html

[1] World Business Council for Sustainable Development, as stated in the KPMG International Survey of Corporate Responsibility, 2005.

[2] Business for Social Responsibility: www.bsr.org

clarity around the definition of corporate responsibility is indicative of the confusion and lack of consensus within the corporate responsibility movement itself.

For the purpose of this paper, corporate responsibility is assumed to refer to the process whereby a company considers and manages the long-term impact of its decisions on its stakeholders. The term stakeholder is also open to a multitude of definitions but the most comprehensive is that used in the recently formulated United Nations *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* ("the Norms").[3] The Norms define "stakeholder" to include stockholders, other owners, workers and their representatives, as well as any other individual or group that is affected by the activities of transnational corporations or other business enterprises. In addition to parties directly affected by the activities of business enterprises, stakeholders can include parties which are indirectly affected by the activities of transnational corporations and other business enterprises such as consumer groups, customers, governments, neighbouring communities, indigenous peoples and communities, non-governmental organizations, public and private lending institutions, suppliers, trade associations and others.[4]

ii. The importance of public reporting

Corporate responsibility has become closely associated with public reporting. The push for greater corporate accountability incorporates a demand for increased corporate transparency and is being responded to by some companies by publishing reports that take into account the environmental and social impact of their activities. The increasing importance of reporting on social and environmental issues is vindicated by the results of KPMG's most recent international survey of corporate responsibility.[5] KPMG reports that 64 percent of the top 250 companies of the Fortune 500 are now issuing corporate responsibility reports.[6] In Australia, the figure drops to 23% of companies producing such reports.[7] Corporate responsibility reporting, at least internationally, appears to be moving from the fringe to mainstream.

That disclosure is a theme of the modern corporate regulatory system is undisputed[8] but as to whether current laws provide sufficient incentive or requirement for

[3] Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, U.N. Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003); Para. I.22 (hereinafter 'the Norms').

[4] Also see the definition of stakeholder adopted by the World Business Council for Sustainable Development which includes shareholders, employees, business partners, suppliers, pressure groups, local communities and the enviroment; World Business Council for Sustainable Development, *Corporate Social Responsibility, The WBCSD's Journey* (2002), 2. This definition of stakeholder is used by the Australian government in the Department of Environment and Heritage's report, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (2003) and the Department of Family and Community Services' draft report, *Triple Bottom Line Reporting in Australia – A Guide to Reporting Against Social Indicators* (2004). Also see, Bryan Horrigan, 'Fault Lines in the Intersection between Corporate Governance and Social Responsibility', *UNSWLJ* Vol. 25(2) 2002, 515 at 520 for his definition of 'inner circle' stakeholders like employees, customers and creditors and 'outer circle' stakeholders like regulators, interest groups and the wider community.

[5] KPMG International Survey of Corporate Responsibility June 2005.

[6] Ibid at 4. This figure combines those companies issuing separate corporate responsibility with those issuing corporate responsibility information in their annual report.

[7] Ibid at 10.

[8] Current disclosure requirements involve the provision of information by companies to the public in a variety of ways For example, Australian Stock Exchange (ASX) Listing Rule 3.1 (given legislative force by s.674 of the *Corporations Act)* is the foundation of the 'continuous disclosure' regime for public companies. It requires that

companies to report on the social (generally understood here to primarily encompass human rights and labour rights issues)[9] and environmental impacts of their activities is a more contentious issue.

The starting point is to ask why companies should report at all with respect to social and environmental issues (often typecast as 'non financial' matters)? What is or should drive business to report on these matters? In some cases, regulatory developments mandating reporting are driving companies to integrate reporting on social and environmental issues into financial reports. [10] The aim is to foster transparency and establish a baseline for future information sharing with stakeholders. The increasing prevalence of ethical investing is another factor influencing the increase in corporate responsibility reports. Interest in socially responsible investing (SRI) has intensified in recent years evidenced by both the estimated increase in the size of SRI funds and the increase in shareholder resolutions concerning social and environmental issues.[11] Other factors driving increased reporting on social and environmental issues include attempts to preserve corporate reputation, risk management strategies, fostering competitive advantage in recruitment and the increasing use of targeted action by vigilante consumer and non governmental organizations (NGOs). These factors are all separate but connected drivers which are increasing the pressure to make corporate practices more transparent and answerable to a broader class of stakeholders beyond simply the company's shareholders. The uptake of corporate responsibility reporting is perhaps indicative of a growing realisation that in asking the question 'Is it good for shareholders?' cannot be answered in isolation from considering the relevance of a particular issue to the company's broader class of stakeholders.[12]

To broaden the scope of corporate reporting beyond pure financial issues means, in many cases, attempting to replace 'single bottom line' (i.e. profit based) thinking and practices with 'triple bottom line' processes (i.e. where a company examines the social, environmental and economic effects of its performance on the wider society,

once an entity 'becomes aware of any information concerning it that a reasonable person would expect it to have a material effect on the price or value of the entity's securities, the entity must immediately tell the ASX that information' (subject to certain exceptions).

[9] For further discussion on what social issues should be disclosed see below Section 3(ii).

[10] See discussion below at Section 3(ii) 'Current and Emerging Regulatory Initiatives'.

[11] Social Investment Forum, *2003 Report on Socially Responsible Investing Trends in the United States* (2003) available at http://www.socialinvest.org/areas/research/trends/sri_trends_report_2003.pdf. The 2003 report notes that a total of $2.16 trillion in assets was identified in professionally managed U.S. portfolios using one or more of the three core socially responsible investing strategies – screening, shareholder advocacy, and community investing. It estimates that more than one out of every nine dollars under professional management in the United States today is involved in socially responsible investing (p. 4). The report also notes that between 2001 and 2003, shareholder advocacy activity increased by 15 percent, growing from 269 resolutions filed in 2001 to 310 in 2003. The report notes that this is indicative of international trends. In Australia, it is estimated that SRI in 2003 amounted to at least $21.3 billion representing a significant increase in recent years. See, Ethical Investment Australia, *Socially Responsible Investment in Australia 2003* (October 2003), 4.

[12] Many debates attempt to define a corporate responsibility model by referencing the distinction between the shareholder and stakeholder primacy views as determinative of the purpose of a corporation. The arguments in this paper adopt the middle ground that recognises that the primary role of directors is to promote the success of the company for its members but that this can not be done without specific consideration of the interests of its stakeholders and that taking into account material social and environmental issues is a necessary part of such deliberations. The debate over the role of the corporation will not be further discussed in this paper but see generally; Bryan Horrigan, 'Fault Lines in the Intersection between Corporate Governance and Social Responsibility', *UNSWLJ* Vol. 25(2) 2002, 515 and for an alternate view see, Samuel Gregg, 'Stakeholder Theory: What it means for Corporate Governance', *Policy* Winter (Jun-Aug) 2001 where it is argued that stakeholder theory is an incoherent and implausible guide to how corporations should act.

and reports publicly on progress). Triple bottom line reporting aims to highlight the view that a company's consideration only of financial matters as an indicator of its success is inadequate.[13] Company reporting should also reflect the social and environmental impacts of its activities.[14] Triple bottom line reports reflect this broader process by attempting to find meaningful ways of weighing short term tangible economic factors with more elusive factors, such as human rights and environmental sustainability concepts.

The existence or requirement for companies to disclose relevant social and environmental issues will not by itself prevent all acts of corporate irresponsibility but it may at times act as a deterrent. Disclosure is not an end in itself but a process for comparing corporate performance and institutionalizing a corporate culture which more readily accepts the value of triple bottom line reporting. Without transparency there is no accountability, and without accountability there is no responsibility for change. Public disclosure of corporate practices may lead to increased community empowerment, greater corporate accountability, increased management attention to social issues and ultimately, improved environmental and social performance.[15] Reporting alone is not a panacea but is one increasingly valuable tool for ensuring corporate ownership of the broader impacts of business operations on the community and the environment.

3. The materiality of 'social and environmental' disclosures

One of the fundamental questions about corporate responsibility is that of its limitations. It is never easy, outside the letter of the law, to define that for which a company is responsible and to whom. A balance has to be found between a minimal approach, doing nothing more than a strict reading of the law requires, and the opposite approach that would cause the company to take on responsibilities beyond what may be called, its 'sphere of influence'.[16]

Fuzzy notions of corporate responsibility guided by ethics or good corporate citizenship will not suffice. In order to practically integrate social and environmental concepts with the financial, a link needs to be established in the corporate decision making process that illustrates the significance or materiality of these issues to a company's operations. KPMG's 2005 corporate responsibility survey indicates that this mode of thinking is already well underway in some companies.[17] 74 percent of

[13] Sarre, Rick, "Responding to Corporate Collapses: Is there a role for corporate social responsibility?" (2002) *Deakin Law Review* 1 at 6.

[14] See Section 3(ii) below.

[15] The jury is still out on definitively linking the benefits of reporting with performance but this is much of the reasoning behind the International Right to Know legislation being pursued in the US which would require businesses incorporated in the US or listed on the US Stock Exchange to report to the public their environmental, human rights and labour practices abroad: www.irtk.org. Also see Dhooge, Lucien J. 'Beyond Voluntarism: Social Disclosure and France's Nouvelles Regulations Economiques' 21 *Ariz. J. Int'l & Comp. Law* 441 at 459-460.

[16] The term 'sphere of influence' is used but not defined in both the UN Norms and the UN Global Compact. The Norms above note 3 at Para. A.1. The UN Global Compact asks "companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption".

[17] Note 5 above.

the companies surveyed by KPMG indicate that the reason why they are reporting on and attempting to integrate social and environmental concepts into their business is attributed to 'economic considerations'. The economic reasons were expressed as either directly linked to increased shareholder value or market share or indirectly linked through increased business opportunities, innovation, and reputation and reduced risk.[18] In 2004, *The Economist* acknowledged the growing importance of non financial disclosure in the overall assessment of a company's risk profile but argued that greater discipline and clarity needed to be brought to bear on clarifying to whom, what and when social and environmental issues should be disclosed.[19]

i. Materiality to whom?

Traditionally, the principles governing corporate disclosure have been cached in terms of 'what the reasonable investor would want to know'. For example, Cooke J in *Coleman v Myers*[20] refers to the seminal United States decision of *TSC Industries v Northway Inc*[21] in seeking guidance in defining materiality. While highly context specific (dealing with proxy solicitation) it nevertheless gives a general normative approach as to how materiality has traditionally been considered in corporate law. *TSC Industries* noted that:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote…[If there is] a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available. (p.449)

The emphasis in this instance in defining materiality is on the reasonable investor whose concerns are generally interpreted narrowly as being focused primarily on the financial aspects of corporate performance. However it is logical to assume that the 'reasonable investor' may also have an interest in the social performance of the company and thus the requisite materiality of facts should be interpreted more expansively.[22]

This broader notion of what type of information might be considered material and to whom has been under discussion as part of the United Kingdom's company law review process and has signalled an adoption of a more expansive interpretation as to whom disclosure is directed.[23] In its most recent White Paper examining company law reform the government calls for clarification of reporting requirements and the

[18] Ibid at 18.

[19] 'Leaders: Corporate Storytelling; Non-financial reporting' *The Economist* Nov. 6 2004, Vol. 373, Iss 8400, 13.

[20] 1977 2 [NZLR] 225 at 336

[21] 1976 426 US 438

[22] Cynthia Williams, 'The Securities and Exchange Commission and Corporate Social Transparency' (1999) 112 *Harvard Law Review*, 1197 at 1277 where she argues that it is unlikely that people are either pure economic investors or pure social investors as a company's financial position can be affected by its social and environmental performance.

[23] In July 2002 the U.K. Government published its White Paper "Modernising Company Law". This represented the first part of the Government's response to the final report of the Company Law Review (CLR) published in 2001. The Government gave its support to many of the CLR proposals including one to require British quoted companies to prepare an Operating and Financial Review (OFR) that would cover a number of issues, including a company's impact on the community and environment. See discussion at note 26 below. It's most recent White Paper, "Company Law Reform" March 2005 includes details on the proposed Company Law Reform Bill: www.dti.gov.uk/cld/review.htm

responsibilities of directors in this regard.[24] In particular, it emphasises that while directors must "promote the success of the company for the benefit of its members, this can only be achieved by taking due account of longer term performance and wider interests, such as the interests of employees and the impact of the company's operations on the community and the environment."[25]

Further to this continuing review process and efforts to increase the transparency of British companies, the United Kingdom introduced a new requirement for directors of all quoted companies to prepare an operating and financial review (OFR) for financial years which begin on or after 1 April 2005.[26] The OFR was designed to provide a balanced and comprehensive assessment of the business's performance and the main trends and developments affecting the performance and position of the company now and in the future. The guidance notes to the OFR state that directors are primarily addressing the OFR to shareholders but explicitly states that information in the OFR will also be of interest to "other stakeholders including: employees, suppliers, customers, regulators and other users of reports and accounts such as those particularly interested in the environment and broader community."[27] In an unusual u-turn the government announced in November 2005 that it would be abolishing the statutory requirement for quoted companies to produce an OFR. The United Kingdom's Chancellor Gordon Brown stated that the requirement was being abandoned because it was an example of "gold-plating" European regulations which caused an unnecessary burden on business.[28] In January 2006, Friends of the Earth launched a legal challenge seeking judicial review of the Chancellor's decision to abandon the OFR.[29]

Generally however the company law review process underway in the United Kingdom recognizes that issues that are of significant interest to customers, to employees, to suppliers and to society more widely are, or very likely will become matters of concern for shareholders too. When considering to whom relevant corporate disclosures should be directed, it is logical in the modern economy to now move beyond the stereotype of only focusing on the concerns of the 'reasonable investor'.

ii. Materiality about what?

Guidance in terms of what should be disclosed can be gained from both current and emerging social and environmental regulatory disclosure requirements as well as the development and influence of 'soft law' in this area gleaned from international guidelines, declarations and codes of conducts among other sources.

[24] Department of Trade and Industry, *Company Law Reform* March 2005; www.dti.gov.uk/cld/review.htm

[25] Ibid at 16.

[26] The U.K. *Companies Act 1985 (Operating and Financial Review and Directors Report etc) Regulations* 2005 [S.1. 2005/1011] came into force on March 22, 2005. A quoted company is a British company whose equity share capital: is included in the official list (Part 6 of the Financial Services and Markets Act 2000); or is officially listed in a EEA state; or is admitted to either the NY Stock Exchange or Nasdaq.

[27] Department of Trade and Industry *Guidance on the OFR and changes to director's reports* (April 2005)

[28] See Brown's speech on November 28, 2005 to the Confederation of British Industries; http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/ee59d1c32ce4ec12802570c70041152c?OpenDocument. This was later backed up by the Department of Trade and Industry publishing its draft simplification plan, see: http://www.dti.gov.uk/ewt/cutting_red_tape_plan.doc

[29] http://business.guardian.co.uk/story/0,,1684262,00.html

Current and emerging regulatory initiatives

A number of jurisdictions have begun to make inroads into regulating reporting on social and environmental issues and this section provides a brief overview of recent and emerging initiatives in Australia, the United Kingdom, France and South Africa regulating various forms of triple bottom line reporting.

a. Australia

The 'disclosure' mantra is a major theme of modern company law and although primarily focused on issues that are traditionally viewed as having a direct financial impact on the value of a company,[30] has been expanded in Australian corporate law in two specific instances to include limited consideration of environmental and social issues.[31]

Section 299(1)(f) Corporations Act 2001 (Cth)

With the introduction in July 1998 of section 299(1)(f)[32] Australian public companies and certain proprietary companies (that exceed certain thresholds) are required to include within their annual report, a directors' report that states:

> If the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory – give details of the entity's performance in relation to environmental regulation.

[30] Australian Stock Exchange (ASX) Listing Rule 3.1 (given legislative force by s.674 of the *Corporations Act)* is the foundation of the 'continuous disclosure' regime for public companies. It requires that once an entity 'becomes aware of any information concerning it that a reasonable person would expect it to have a material effect on the price or value of the entity's securities, the entity must immediately tell the ASX that information' (subject to certain exceptions). However there are suggestions that materially significant environmental risk is currently under reported by ASX companies (see Ernst & Young; *The Materiality of Environmental Risk to Australia's Finance Sector* (2003) and submission of Monash Sustainability Enterprise (March 24, 2003) to Treasury on the Exposure Draft-Corporations Amendment Bill 2002. This would be consistent with similar findings in the United States where a 1998 study by the Office of Planning and Policy Analysis, within the EPA's Office of Enforcement and Compliance Assurance, found that 74% of companies did not adequately disclosure environmental issues per SEC rules. Further see, an October 2002 survey by Friends of the Earth indicating that companies were providing inadequate disclosure (in SEC filings) to investors with respect to climate risk (www.foe.org/new/releases/902secsurvey.html) and a 2004 report by the UK Environment Agency detailing the environmental disclosures of companies on the FTSE All Share Index which argued that the vast majority of reports lacked depth, rigour or quantification and that guidance on key performance indicators would help companies decide which environmental disclosures are necessary; www.ethicalcorp.com/content_print.asp?ContentID=2453. Also see The Allen Consulting Group, *Triple Bottom Line Measurement and Reporting in Australia,* (2002).

[31] Also relevant with respect to disclosure of material items are: s.412 (When companies enter into schemes of arrangement to reconstruct their businesses the explanatory statement sent to members or creditors must set out 'information that is material to the making of a decision by a creditor or member whether or not to agree to the compromise or arrangement, being information that is within the knowledge of director's); s.636 (A bidder's statement for a takeover must include details of 'the future employment of the present employees of the target' and 'any other information that: (i) is material to the making of a decision by a holder ; and (ii) is known to the bidder's); and s.710 (If a company is raising funds from the public the prospectus content rules require disclosure of 'all the information that investors and their professional advisers would reasonably require to make an informed assessment of… the assets and liabilities, financial position and performance, profits and losses and prospects of the body').

[32] *Corporations Act* 2001 (Cth). See Frost G. and English L., *Mandatory Corporate Environmental Reporting in Australia: Contested Introduction Belies Effectiveness of its Application* (Nov. 2002), (http://www.econ.usyd.edu.au/drawingboard/digest/0211/frost.html) for a summary of the passage of s.299(1)(f) which notes that it was an unintended outcome of the Federal Government's Corporate Law Economic Reform Program and was a political compromise.

The open ended text of s.299(1)(f) has been criticised as being vague and unclear.[33] The provision does not require disclosure of the financial impact of an environmental issue and as such does not specifically allow for the application of traditional accounting concepts of materiality. Under the current framework, directors are able to use high levels of subjectivity in determining what they should and should not disclose. Despite this lack of clarity, studies indicate that the introduction of s.299(1)(f) significantly improved overall reporting by Australian companies on their environmental performance.[34]

Section 1013D(1) Corporations Act 2001 (Cth)

Section 1013D(1) of the *Corporations Act* requires limited disclosure of environmental, social and ethical factors. Although applying only to financial products it may be influential over time in mainstreaming corporate responsibility issues into the broader corporate arena. In March 2004, a requirement that institutions offering financial products with an investment component disclose (in their product disclosure statements) "the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realization of the investment" became mandatory.[35] The investment products covered by the Australian provision include superannuation products, managed investment products and investment life insurance products. During preparation of the legislation, parliamentarians acknowledged that the new provision was inspired by the 1999 amendments to the UK Pensions Act 1995 discussed below.

This disclosure requirement includes an obligation to disclose if such matters are not taken into account at all.[36] However, if a financial product issuer does claim to incorporate social and environmental considerations in their investment decisions, two disclosure obligations ensue: (1) outlining those issues that it considers constitute labour or environmental, social or ethical considerations, and (2) explaining the extent to which those matters are taken into account in the selection, retention or realization of the investment.

The *ASIC s1013DA Guidelines*[37] do not provide specific guidance on the relevant issues to be considered but suggest that the disclosure statement must include such information 'as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product'.[38] It would be beneficial for companies to receive further guidance than is provided in this rather vague document. However the Guidelines do suggest that the disclosure statement should mention measurement criteria upon which the financial institution relied in assessing the relevance of such issues. For example, if the product issuer claims to only invest in companies with good labour relations, they must demonstrate how they measure compliance with this goal (e.g. number of strike days, above award

[33] Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on Matters Arising from the Company Law Review Act 1998* (tabled on 18 December, 2000).

[34] Frost G. and English L., note 32 above at 5.

[35] *Corporations Act* 2001 (Cth), s. 1013D(1) (inserted by the Financial Services Reform Act 2001 (Cth).

[36] *Corporations Regulations* 2001, Clause 7.9.14C

[37] Australian Securities & Investment Commission, *Section 1013DA disclosure guidelines; ASIC guidelines to product issuers for disclosure about labour standards or environmental, social and ethical considerations in Product Disclosure Statements (PDS),* December 2003; http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/s1013DA_finalguidelines.pdf/$file/s1013DA_finalguidelines.pdf

[38] Ibid at 11.

conditions etc). The Guidelines provide no detailed guidance on exactly what standards should be used but (in its background commentary) suggests the Global Reporting Initiative, standards devised by Standards International and International Labour Organization and United Nations Declarations are relevant in assisting with triple bottom line reporting requirements.[39]

This legislation, while still relatively open ended, at least cements the legitimacy of incorporating social and environmental considerations in investment decision-making. The question as to what are the relevant standards and considerations on how to incorporate them appears to be being left largely to be determined by the market, which now in a broad sense extends beyond the ethical investment and mainstream investment markets, to incorporate community expectations with respect to the relevance and legitimacy of labour or environmental, social or ethical considerations.

b. United Kingdom

Company Law Reform Bill

The proposed *Company Law Reform Bill* aims to clarify the general duties which directors owe to the company in the context of more accurately reflecting modern business needs and wider expectations of responsible business behaviour.[40] In considering the general duty of directors to promote the success of the company for the benefit of members, the Bill requires directors (where relevant and so far as reasonably practical) to take account of the long and short term impact of such decisions having regard to the interests of its employees and its ability to foster its business relationships with its suppliers and customers, and to consider the impact of its operations on the community and the environment.[41] This explicit integration of social and environmental concerns into the decision making purview of the company directors recognises the material nature of these issues to business operations.

Operating and Financial Review

As discussed above, the new requirement for certain British companies to produce an Operating and Financial Review (OFR), is now in doubt given the November 2005 decision by the United Kingdom government to abandon this requirement. However it is still instructive to reflect on the deliberations of the OFR Working Group on Materiality when considering what type of information companies should disclose. The Group noted that:

> Information will be material to the OFR if failure to disclose it clearly, fairly and unambiguously might reasonably be expected to influence member's assessment of the company and hence the decisions they may take, either directly or indirectly as a result of the significance that the information has for other stakeholders and thus the company. Information that is material to the OFR may be *quantitative or qualitative; and may relate to facts or probabilities, and to past, present or future events and decisions*. [Emphasis added][42]

[39] Ibid at 16.
[40] See text at note 23 above and Ch. 3.3 of the White Paper on this Bill.
[41] *Company Law Reform Bill* 2005 note 24 above, Part B, Ch. 1 B.3.
[42] *OFR Working Group on Materiality, A Consultation Document*, para. 20. http://www.dti.gov.uk/cld/ofrwgcon.pdf

The OFR Working Group definition acknowledges the difficulty of reporting on some of the more amorphous social and environmental concerns but makes it clear that the difficulty of quantifying and reporting them does not disqualify the need for such disclosure.

In terms of what issues should be disclosed the OFR referred to information about environmental matters, company employees and social and community issues.[43] Ultimately it was still up to the directors to provide a sufficient amount of information on such issues "to the extent necessary" to comply with the objectives of the OFR; that is to provide a balanced and comprehensive analysis of business strategies including a description of the principal risks and uncertainties facing the company.[44] Directors were required to make judgments about what data and analysis to include and the level of appropriate detail. However by stipulating such reporting requirements, it does make clear that such social and environmental issues are intrinsically linked to business operations so as to likely constitute a material item for disclosure.

Pensions Regulations: SRI

The extent to which stock markets are major factors in promoting corporate responsibility is still open to question[45] however legislation such as that introduced in the United Kingdom in 1999 - Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations (1999)[46] – is likely to be influential in advancing the prominence of corporate responsibility issues. This Regulation requires trustees of occupational pension funds (as of 3 July 2000) to disclose on the Statement of Investment Principles (a) the extent (if at all) to which social, environmental or ethical considerations are taken into account in their investment strategies and (b) their policy (if any) in relation to the exercise of rights (including voting rights) attached to investments. Legislation such as this and the Australian legislation discussed above, forces fund managers who may not previously have considered these issues to now, at least stop and acknowledge that such concerns have not been taken into account in their decision making process.

c. France

The New Economics Regulations (NRE) was adopted in May 2001 by the French Parliament and came into force on January 2002.[47] The NRE is an attempt to modernize France's company law framework and predominantly deals with financial issues (such as the transparency of takeover bids, improving corporate governance and strengthening antitrust regulation) but also legislates for the reporting of a

[43] *The Companies Act* 1985 *(Operating and Financial Review and Directors Reports etc) Regulations* 2005. Schedule 7ZA (4).

[44] Ibid at (1-3).

[45] The ethical investment market is gaining mainstream acceptance in Australia with institutions like Westpac and Rothschild now offering 'ethical' products. While in 2002 ethical funds represented just over 1% of funds managed in Australia (($1.3 billion) this figure is forecast to rise to $40 billion by 2020. Fitzgerald S, *Corporate Accountability for Human Rights Violations in Australian Domestic Law (2002)* unpublished, copy on file with author.

[46] Regulation 11A of the Occupational Pension Schemes (Investment) Regulations (1996) UK (inserted by Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations (1999) requires trustees of occupational pension schemes in preparing their statement of investment principles under section 35 of the Pensions Act 1995 (UK) to take into account the factors noted above.

[47] Law No.2001-420 Nouvelles Regulations Economiques (New Economics Regulation) Article 116

company's triple bottom line performance. Article 116 mandates disclosure of social and environmental issues in annual reports and accounts. It requires all companies listed on the "premier marche" (those with the largest market capitalizations) to report against a template of social and environmental issues, including those related to human resources, community issues, and engagement and labour standards, and health, safety and environmental standards. The new law aims to provide baseline sustainability reporting standards that French corporations can voluntarily build upon and institutionalizes the concept of triple bottom line reporting.

Notably the law is silent as to perimeters (geographical or otherwise) of the reporting requirement and does not specify if the regulation affects the subsidiaries, business partners, joint venturers etc of the company. While identifying the principal subject areas for disclosure, the law does not set out the specific indicators by which a corporation must report on the relevant issues and thus handicaps its aim to promote harmonization and standardization of non-financial reporting.[48] Significantly, the law also fails to provide any sanctions for non-compliance with the disclosure requirements. However, Article 116 represents a milestone in triple bottom line reporting by attempting to enumerate the relevant social and environmental issues that affect business. The NRE is significant in institutionalising corporate responsibility issues beyond their relevance purely to the ethical investment community and recognises the indivisibility of business activities and social and environmental concerns including the relevancy of information relating to their interaction to investors and other stakeholders.[49]

d. South Africa

As of September 1, 2003 all companies listed on the Johannesburg Stock Exchange (JSE) are requested to comply with codes created in 2002 by second King Report on Corporate Governance for South Africa, the so called King II Report.[50] These codes not only address core corporate governance issues, such as director independence but also require the use of Global Reporting Initiative (GRI) guidelines for disclosing social and environmental performance. King II's Code of Corporate Practices incorporates a provision on Integrated Sustainability Reporting, which states that:

> Disclosure of non-financial information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines...[51]

Companies are requested to report annually on the nature and extent of its social, transformation, ethical, safety, health, and environmental management policies and practices. It is expected that the use of GRI guidelines in reporting such issues will lead to greater standardization in disclosure practices. The Code specifically notes that it is the board of directors' duty to present a balanced assessment of the company's

[48] Hoffman E., *Environmental Reporting and Sustainability Reporting in Europe,* (2003) (http://www.iges.or.jp/en/be/report7.html).

[49] Dhooge, Lucien J. note 15 above at 442. Also see ORSE 'Assignment Report submitted to the government; Critical review of how companies are applying French legislation on social and environmental reporting', April 2004.

[50] King Committee on Corporate Governance, March 2002, 'Code of Good Governance' can be accessed at www.iodsa.co.za

[51] Ibid at 35.

position and that the reporting should address material matters of significant interest and concern to *all* stakeholders. The requirements of King II thus embody the broader concepts of materiality, stakeholders and directors' duties that are envisaged in the reform of the Uki's. company law. King II arguably paves the way for more responsive corporate disclosure framework by noting that 'reports and communications must be made in the context that society now demands greater transparency and accountability from companies regarding their non-financial matters'.[52]

International soft law developments and the influence of corporate practices

In addition to regulatory changes, materiality is also being redefined on the ground – by the continuing development of soft law initiatives linking business with social and environmental concerns, through pressure on business from wider civil society and through precedents established by company practice and reporting processes. Through these developments the definition of materiality is being practically extended to encompass information beyond simply traditional financial information.[53] Issues that are often categorized as non financial aspects are implicitly being taken to be material.[54] The challenge lies in folding in the emerging consensus on social (generally understood here to primarily encompass human rights and labour rights) and environmental concerns to a broader understanding of issues that are material to a company and thus require public disclosure.[55] Guidance on what are the key issues for corporate disclosure can be gained by a brief review of the relevant international law and guidelines as well as corporate practices in developing codes of conduct to guide responsible behaviour.

The Universal Declaration of Human Rights 1948 (UDHR) is the most widely accepted codification of universal human rights and as such acts as a road map indicative of the definitive human rights issues of the modern era. It encompasses a broad range of rights including the right to freedom of thought, conscience and religion, freedom of peaceful assembly and association, the right to just and favourable conditions of work and the right to an adequate standard of living. The preamble to the UDHR notes that it is:

> a common standard of achievement for all peoples and all nations, to the end that every individual and *every organ of society…*

It is arguable that the UDHR directly applies to companies as an 'organ of society' and that as such they are called upon to promote, respect and secure the recognition of

[52] Ibid at 39.

[53] Westpac's annual report is an example of an expanded and reshaped annual report that reflects the needs of customers and the community to understand the wider impact of the company on society.

[54] "What a reasonable investor would need to know about a company to make financial and voting decisions won't change…but what reasonable investors and the public at large find important over time does change, so issues like global warming…human rights can be included in the purview of what's 'material'", quote by Michele Chan Fisher, Friends of the Earth, July 11, 2003 www.ishareowner.com/news/article.cgi?sfArticleId=1170

[55] For example see the US based Corporate Sunshine Working Group's list of 20 proposed expanded corporate disclosure items, which have been selected for their financial value-relevance, as well as their ability to enhance corporate governance and responsibility. http://www.corporatesunshine.org/proposedisclosure.pdf . Also see: Williams C 'The Securities and Exchange Commission and Corporate Social Transparency', *Securities Law Review* Annual 2000 v32 3-117, appendix I for models of expanded disclosure.

these rights, particularly those directly applicable to business. [56] However, while responsibility may be accepted by some companies[57] unanimity on the exact nature of those duties and the applicable rights, has not yet been achieved.

While the UDHR itself, as a declaration, is not legally binding, other documents produced by the United Nations which essentially codify the UDHR, do produce legally binding obligations on states (not directly on companies) that are party to them. The two key human rights covenants are the International Covenant on Economic, Social & Cultural Rights (ICESCR, 1966) and the International Covenant on Civil & Political Rights (ICCPR, 1966). Rights includes specific rights relevant to business such as the right to work, the right to a minimum wage, the right to form trade unions and the right to health.

There are also a number of non binding international declarations concerning environmental rights and sustainable development- the Declaration of the United Nations Conference on the Human Environment (Stockholm, 1972)[58] and the Rio Declaration on Environment and Development (1992)[59] - but in contrast to international human rights documents, a distinct lack of any binding universal standard. Guidance can also be found in a number of regional and multilateral plans which can be said to represent a global consensus of states,[60] such as Agenda 21[61], the Monterrey Consensus (on financing for development, 2002)[62] and the UN Millennium Goals for Development (2000). While not legally binding, and thus more aspirational than obligatory, these documents explicitly acknowledge the role that companies, along with governments, have in promoting environmental and human rights.[63] These treaties and documents, along with voluntary guidelines formed both at an international level and within individual companies as codes of conduct provide indicia for divining consensus on which social and environmental issues are relevant to business.

Since the 1970's a number of inter-governmental organizations have formed voluntary guidelines, declarations and codes of conduct to regulate the activities of corporations and all are of assistance in determining those social and environmental

[56] International Council on Human Rights Policy, *Beyond Voluntarism; Human Rights and the developing international legal obligations of companies* (2002): 58-64, Sullivan R: `Business And Human Rights Dilemmas And Solutions;` 2003 at 15, Henkin, L., The Global Market as Friend or Foe of Human Rights: The Universal Declaration at 50 and the Challenge of the Global Markets, (1999) 25 *Brooklyn Journal of International Law* 17 at 25.

[57] For example, the Body Shop's charter explicitly aims to "balance the financial and human needs of its stakeholders: employees, customers, franchisees, suppliers and shareholders" and assumes an indirect role in protecting human rights (i.e. through collaboration with Amnesty International).

[58]UN doc A/CONF.48/14/Rev. 1 (1972)

[59] UN Doc/A/CONF.151/5/Rev.1 (1992)

[60] International Council on Human Rights, note 55 above at 65.

[61] Agenda 21, the Rio Declaration on Environment and Development, and the Statement of principles for the Sustainable Management of Forests were adopted by more than 178 Governments at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro, Brazil, 3 to 14 June 1992. Agenda 21 is a plan of action to be taken globally, nationally and locally by organizations of the United Nations System, governments, and major groups in every area in which human impacts on the environment.

[62] See http://www.un.org/esa/sustdev/documents/Monterrey_Consensus.htm

[63] See Agenda 21, Chapter on Business and Industry, and see also, The Beijing Declaration and Platform for Action, adopted by the Fourth World Conference on Women, Beijing 4-15 September, 1995, which puts specific responsibilities on the private sector with respect to preventing violence against women, (paras. 125 and 126), strengthening women's' economic capacity (para. 177) and promoting work and family compatibility (para. 180).

issues considered most relevant to business. The most notable of these voluntary agreements are:

- Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises (revised 2000)[64]
- ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (1977)[65]
- ILO (1998) Tripartite Declaration on Fundamental Principles and Rights at Work
- UN Global Compact (2000)
- UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights (2003)

The OECD Guidelines and the ILO Tripartite Declarations were revolutionary in the sense that they explicitly focus on outlining the obligations of companies with respect to protecting human and environmental rights but they are subject to severe limitations. Apart from the fact that they are non binding, their implementation mechanisms are extremely weak, the duties outlined are broad and lack details.

More recently the United Nations established the Global Compact (2000), whereby UN Secretary General Kofi Annan called on world business leaders to voluntarily "embrace and enact" a set of ten principles relating to human rights, labour rights, the protection of the environment and corruption, in their individual corporate practices.[66] The labour and human rights standards reflect those accepted norms as laid out in the ILO's Tripartite Declaration on Fundamental Principles and Rights at Work and the UDHR, but the Compact does little to advance the debate toward clarifying what the key environmental issues are for business.[67] The principles cited in the Global Compact do not constitute a sufficient basis for designing enforceable standards, even though they may provide overall guidance and are beneficial more from the point of view of acting as yet another indicator of the relevance of international human rights and environmental norms to business.[68]

The most promising initiative to emerge recently is the United Nations *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with*

[64] (2000 revision), adopted 27 June 2001. The OECD Guidelines are part of the OECD Declaration on International Investment and Multinational Enterprises, OECD document no. DAFFE/IME/WPG(2000)15/FINAL The Guidelines were first adopted in 1976 and revised in 2000.

[65] The Declaration can be seen as providing guidance for how corporations should implement the fundamental ILO conventions. The overarching obligations with respect to labour rights are set out in the eight fundamental conventions of the International Labour Organization: Forced Labor Convention (No. 29); Freedom of Association and Protection of the Right to Organize Convention (No. 87); Right to Organize and Collective Bargaining Convention (No. 98); Equal Remuneration Convention (No. 100); Abolition of Forced Labor Convention (No. 105); Discrimination (Employment and Occupation) Convention (No. 111); Minimum Age Convention (No. 138) and Worst Forms of Child Labour Convention, 1999 (No. 182). These conventions are legally binding on those states that have ratified them. Obligations then exist at a national level to ensure enforcement of these rights by corporations; they do not directly bind companies.

[66] Originally launched in 2000 with nine principles, the tenth relating to corruption was added in June 2004 at the Global Compact Leaders Summit available at www.unglobalcompact.org

[67] Principles 7,8 and 9 of the UN Global Compact encourage businesses to support a precautionary approach to environmental challenges; undertake initiatives to promote greater environmental responsibility; and encourage the development and diffusion of environmentally friendly technologies: www.unglobalcompact.org

[68] See criticisms of the Global Compact by the Lawyers Committee for Human Rights (now Human Rights First), Human Rights Watch, Oxfam International and Amnesty International: http://www.humanrightsfirst.org/workers_rights/issues/gc/index.htm

Regard to Human Rights (2003) (the Norms).[69] In August 2003, the UN Sub-commission on the Promotion and Protection of Human Rights adopted this comprehensive set of international norms specifically applying to transnational corporations and other businesses (thus applying to any business entity regardless of its international or domestic nature). [70] The Norms are based not only on international instruments and non binding declarations and guidelines adopted by multilateral organizations, but also on industry initiatives, framework agreements between corporations and workers' organizations, corporate codes of conduct and non-governmental organisations (NGOs) and union guidelines. The Norms and the accompanying interpretative Commentary, while not 'black-letter law', constitute the most authoritative interpretation to date of the duties and responsibilities owed by business with respect to human and environmental rights.

The Norms provide a new benchmark against which companies will be increasingly be assessed. They cover a broad range of issues and include the most fundamental and basic rights that have been agreed as accepted standards for nation states and individuals for decades. The Norms should be used as a base from which to determine those issues most relevant for social and environmental disclosure.

Key issues referenced in the UN Norms as relevant to business:

- Right to equal opportunity and non discriminatory treatment
- Right to security of persons (including no engagement in or benefit from war crimes, crimes against humanity, genocide, torture, forced disappearance, forced or compulsory labour, hostage taking, extrajudicial, summary or arbitrary executions.
- Rights of workers (including forced or compulsory labour, child labour, safe and healthy working environment, remuneration, freedom of association and collective bargaining)
- Respect for national sovereignty and human rights (including prohibitions against bribery and corruption and respecting rights of indigenous people and use of intellectual property, right to development, adequate food and water, highest attainable standard of physical and mental health, adequate housing, education, freedom of thought, conscience and religion and freedom of opinion)
- Consumer protection (including fair business practices, marketing and advertising)
- Environmental protection (particularly including bioethics, and the precautionary principle and sustainable development).

[69] U.N. Doc. E/CN.4/Sub.2/2003/12/Rev.2 (2003): http://www1.umn.edu/humanrts/links/norms-Aug2003.html

[70] In April 2005 the United Nations Commission of Human Rights following up on the development of the Norms, called on the U.N. Secretary General to appoint a Special Representative on the issue of business and human rights for an initial period of two years to investigate further the legal responsibilities of business for social and environmental issues; E/CN.4/2005/L.87 15 April 2005. The vote in support of the resolution was 49-3. The 3 states who voted against the resolution were the United States of America, Australia and South Africa (although South Africa's vote signalled dissatisfaction with the weakened compromised language of the resolution). The Commission on Human Rights' resolution provides the Special Representative with a mandate to: clarify the standards of corporate responsibility; elaborate on the role of States in regulating business; define concepts such as 'complicity' and 'spheres of influence', develop methodologies for human rights impact assessments of the activities of business; and compile a compendium of best practices. On 28 July 2005 the UN Secretary General appointed Professor John Ruggie as the UN Special Representative. Professor Ruggie previously served as UN Assistant Secretary-General and senior adviser for strategic planning from 1997 to 2001. He was one of the main architects of the United Nations Global Compact. The Special Representative is due to hold broad-based consultations and issue two reports, an interim one in 2006 and a final one in 2007.

Complementary to the international development of broad based multilateral guidelines guiding corporate responsibility has been the growth, particularly in the last fifteen years, of codes of conduct developed by companies, trade organizations, NGOs and multi-stakeholder bodies largely aimed at delineating business's responsibilities with respect to human rights and environmental issues. Levi Strauss & Co. led the way in the early 1990's followed soon after by a raft of companies such as Gap Inc., Nike, Shell and BP Amoco, notably principally representative of the apparel/footwear sector and extractive industries. These codes, while often content and sector specific do indicate some consensus on the relevant social and environmental issues of concern to business. Many were drafted in a reactive manner as a response to public criticism of specific business practices but nevertheless reflect issues which companies, consumers, workers and others were motivated to address in a very public manner.[71]

The growth and influence of the socially responsible investment market also provides a forum for divining emerging consensus on the social and environmental issues most relevant to business.[72] The Dow Jones Sustainability Index (launched in 1999)[73] and the FTSE4Good (launched in 2001 by the Financial Times Stock Exchange)[74] aim to establish a baseline of "challenging but achievable" standards for corporate responsibility. Both emphasize environmental sustainability, labour rights and human rights with the Dow Jones Index taking a noticeably more detailed approach to defining environmental sustainability by particularly valuing corporate performance with respect to issues such as energy consumption, greenhouse gas emissions, water usage, waste generation and climate strategies. Other popular code issues such as corruption and bribery and security practices are also emphasized.

This growing sense of convergence of issues, most recently evidenced by the development of the Norms, suggests that at some level, it is both possible and necessary to begin to define those issues most relevant for corporate disclosure. By tracking the development of these soft law and corporate initiatives along with the emerging regulatory reporting requirements it is now possible to develop a basic checklist of the principal social and environmental issues of concern to business. As to the appropriate level of detail such issues are reported on depends on their relevance to the specific company. As such it is important when encouraging or mandating increased levels of social disclosure for regulatory agencies to not only

[71] See generally, Posner M. and Nolan J. 'Codes of Conduct and Workers Rights?' in Flanagan, R. and Gould IV, W. (2003) *International Labor Standards: Globalization, Trade and Public Policy*, Stanford, Stanford University Press. Also see, Gordon K. and Miyake, M. "Deciphering Codes of Corporate Conduct: A Review of their Contents" Working Papers on International Investment, Number 1999/2. Organization for Economic Co-operation and Development. November 1999. This OECD study was the result of an investigation of 246 voluntary codes collected "from business and non-business contacts which OECD Member governments helped identify" (at 8.). Out of this set of codes, they found that 118 or 49% of them where issued by individual companies (mostly multinationals), while 34% were industry and trade association codes, 2% issued by an international organization, and 15 % by partnership of stakeholders (mainly NGOs and unions) (at 9). Also see *Strengthening Implementation of CSR in Global Supply Chains,* World Bank Group, CSR Practice (October 2003) which noted that "while codes themselves have in many ways converged in content and form, inconsistent interpretation and application of the provisions presents the greatest source of confusion". The study was limited to the agriculture and apparel sectors.

[72] Note 11 above.

[73] http://www.sustainability-index.com/

[74] The FTSE4Good is not itself an SRI fund but is a tool that can be used by fund managers to assess the social, ethical and environmental 'worth' of a company. http://www2.ftse.com/ftse4good/FTSE4GoodCriteria.pdf

provide guidance on those particular social and environmental issues most relevant to business but also direction as to when such disclosure is necessary.

iii. What drives materiality: when is disclosure necessary?

Whether or not a particular piece of information is material for disclosure will depend on a number of factors; equally relevant to the preparation of financial statements as to the disclosure of social and environmental issues. Two principal factors determinative of *when* disclosure is required necessitate consideration of both the short and long term impact of the issue on a company's performance and are:

- **The nature and, where relevant, the size and effect of the item concerned judged in the particular circumstances of the case.** This requires the item to be assessed individually but also in the broader context of other disclosures. The item by itself may not appear material but when combined with other factors impacting the business may take on greater significance. The OFR Working Group on Materiality summarised the test as being "whether the information, were it to be omitted, misstated or inadequately described, would change or influence an understanding of other matters reported upon and thus, potentially, influence decisions".[75]

- **The significance of the issue to business now *and* in the future.**[76] This could be judged in a number of ways including consideration of:

    1. the short term and long term financial impact of the issue on business operations;
    2. the recognition awarded to the issue by the company whether evidenced through policy statements, board discussions or other means;
    3. the significance of the issue to business peers;
    4. the relevance of the issue to stakeholders; and
    5. whether the issue is reflective of current societal norms.[77]

4. Conclusion

[75] OFR Working Group on Materiality, note 41 above at 19.

[76] Ibid at 20.

[77] Accountability (Institute of Social and Ethical Accountability), *Redefining Materiality* (June 2003) at 27. Societal norms may be reflected through the processes highlighted above in Section 3(ii) dealing with the influence of soft law developments and corporate practices.

> Neither organisations nor individuals are likely to take corporate social responsibility seriously as part of their core business unless it is effectively integrated within corporate governance.[78]

Mandating triple bottom line reporting with clear guidance as to when social and environmental issues are material and thus require disclosure is a necessary step in institutionalizing corporate responsibility. The primary role of the directors will always be to promote the success of the company but it is now the duty of directors to recognize (and be required to recognize) that success is more likely when the board takes a broad view of all the factors that influence success. This includes a company's relationship with its stakeholders; that is its shareholders, other owners, workers and their representatives, as well as any other individual or group that is affected by the activities of the company. Triple bottom line reporting runs the risk of tokenism unless and until regulatory agencies are willing to mandate its requirement for a significant number of companies and provide specific guidance as to what and when social and environmental matters should be disclosed. International developments are outstripping the speed at which Australian companies are adopting corporate responsibility practices. It is time for Australian regulatory bodies to keep pace with these economic, social and environmental developments.

Yours sincerely,

Justine Nolan
Lecturer
Faculty of Law
University of NSW
Sydney NSW 2052

[78] Horrigan B, note 4 above at 521.

Australian Government Corporations and Markets Advisory Committee

Corporate Social Responsibility, Discussion Paper, November 2005

Introduction

The Environment Institute of Australia & New Zealand ("the Institute") welcomes the opportunity to comment on the CAMAC Discussion Paper on Corporate Social Responsibility.

About the Environment Institute of Australia & New Zealand

The Environment Institute of Australian and New Zealand is a professional association established to meet the needs of environmental practitioners in Australia and New Zealand. The Institute is genuinely multi-disciplinary and was formed specifically for those who work in any of the numerous aspects of the environmental profession.

The primary purposes of the Institute are to:

a) facilitate interaction among environmental professionals;

b) promote environmental knowledge and awareness; and

c) advance ethical and competent environmental practice.

The vision of the Institute is to "sustain the environment by assuring excellence in environmental people and practice".

Response to the Discussion Paper

To make the transition to a sustainable society in a truly effective and efficient manner, the Institute would like to bring to the CAMAC's attention that it is the skills of people that will make this happen. On the assumption that there is, or will be, a basis of sound legislation, the more competent, effective and efficient professional practitioners are, and the more supportive the public policy settings and corporate governance structures are, the better the environmental and sustainable outcomes will be.

The Institute accepts the concept of Corporate Social Responsibility (CSR) and sees it as an important mechanism for engaging corporations and ensuring transparency in an organisation's approach to managing its surrounding environment and interaction with the community. The Institute does not see the need to develop a new system of application of CSR in Australian organisations and is satisfied with the systems already in use, such as the Global Reporting Initiative (GRI). However, there has been some ambiguity around CSR. Accordingly, since the Institute has the expertise to express an opinion on a number of matters relevant to the Discussion Paper, this submission is the

Institute's contribution to assist the Australian Government in making CSR worthwhile for both the business sector and the wider community.

1. Corporations Law and Directors' Duties

The CAMAC Discussion Paper explains how Australian corporations law does not require a corporation or its board of directors to consider externalities other than the obligation to meet compliance requirements of other laws. The CAMAC Discussion Paper gives a strong argument as to why boards and their directors can **not** be obliged to favour environmental externalities or the wellbeing of third parties over their shareholders' interests. However, in other jurisdictions (e.g. in Europe) there is permission in their corporations law for a corporate board to consider CSR in their decisions. European jurisdictions allow corporate boards to address climate change implications, local community implications and the product stewardship of their goods.

Irrespective of jurisdiction, it would appear that the paramount duty of directors is to act in the interests of the corporation's shareholders. So to the extent that CSR considerations adversely affect the financial interests of shareholders, such matters may not be seen as in the shareholders' interest. Notwithstanding any inclination that a benevolent board has to enhance the natural environment, to benefit a local community or to improve the living standard of their customers and employees, it would appear that where the shareholders' interests materially conflict with the broader community's interest – then the shareholders' interests prevail.

Accordingly, the Institute concludes that under the current legislation, no matter how well intentioned, whenever there is a net financial cost in implementing CSR, the primacy of shareholders' interests is an unfortunate obstacle to CSR.

This same argument stands also for the corporate implementation of sustainable practices in a corporation, except for short payback projects, cheaper programs or corporate image promotions.

Against this background, the Institute's view is that Australian corporations law should be amended to require company directors and business managers to take relevant environmental and social considerations into account in their decision-making. This means elevating environmental and social issues beyond the level of compliance to a more strategic level and making them central to corporate decision-making. It may also mean that the due diligence responsibilities of directors and managers in relation to the environment and community need to be strengthened.

This does not remove the need for appropriate legislation designed to achieve particular CSR objectives. Indeed, the Institute recognises that in some circumstances specific legislation may have advantages over more general corporations law, including greater certainty and better enforceability. Ideally, corporations law would provide a strategic framework for corporate social responsibility, supported by more specific legislation where this is necessary to achieve particular CSR objectives. Relevant supporting legislation could include, for example, environmental, occupational health and safety, and trade practices law.

The Institute proposes, however, that to the extent that current corporations law prevents or discourages corporate decision-makers from taking CSR considerations into account in corporate decision-making because of a conflict between the interests of shareholders and the interests of the wider community, the solution must lie in reforming corporations law.

2. Not reporting for the sake of reporting

In any reporting exercise there is always the danger of ultimately reporting for the sake of reporting and thereby making it a "tick-box" exercise. The Institute has the experience to foresee that there is some danger of this happening to CSR reporting. One mechanism to prevent CSR reports becoming a "tick box" exercise is to ensure the purpose is outcome focussed. Another safeguard is to set the scope and level of CSR reporting in proportion to the size and/or impact of an organisation.

Currently the minimal level of CSR reporting demonstrates compliance and nominates each corporate breach of relevant legislation. However, the Institute agrees that CSR is beyond compliance, so a CSR report should also go beyond compliance.

3. Mandatory CSR reporting

The Environment Institute sees merit in the introduction of some form of mandatory CSR reporting, to increase the level of attention paid by senior management in the private sector to environmental issues, as well as social and broad economic issues. A critical issue would be in defining the threshold at which mandatory reporting would be a requirement. (One threshold, say, could be for ASX300 companies to be obliged.) This could only be defined by directly engaging the business community in the decision.

The Institute has the view that a combination of incentives and penalties could be used to promote CSR reporting. For example, the largest companies could be required to report, the smallest companies could be exempted from mandatory reporting, and those in between could be *encouraged* to report on CSR.

The Institute sees merit in both integrating CSR reporting into existing financial reports and (alternatively) in publishing separate CSR reports. The most important issue is that a company's environmental, social and broader economic performance or contribution is adequately and truthfully reported to its stakeholders.

This view is based on the premise that better environmental outcomes will only result from more people paying more attention to the interactions their businesses (or businesses in their community) have with the environment. Mandatory CSR reporting is a powerful motivator to take active steps to minimise the adverse effects of those interactions and where possible to help re-generate natural or environmental resources.

4. Ensuring that reporting focuses on the desired outcome: - e.g. capacity to change behaviour, improvement of performance, etc.

Corporate Social Responsibility (CSR) should be outcome focussed rather than process driven. Again this approach will assist in preventing CSR becoming a "tick-box" exercise by ensuring the organisation gets something out of its effort.

Outcomes will differ among organisations but at a minimum they will include improved environmental performance and promotion of positive behavioural change amongst staff. Companies within the organisation's supply chain (both upstream and downstream) should not be neglected in the CSR report.

Where an Australian organisation deals with companies overseas it is important to promote the level of CSR (and sustainable practices) that would be expected back home, by Australian stakeholders. CSR assists organisations that are below standard to improve their performance. From an enforcement perspective, this is applicable where organisations have influence over these below-standard companies, such as being a major client or a purchaser of their goods and/or services.

5. The role of the environment profession and ensuring that qualified environmental practitioners (e.g. CEnvP) are involved

The Australian Government also needs to ensure that practitioners involved in CSR are competent and /or certified to do CSR tasks. Several years ago, the Institute accepted the role of overseeing, on behalf of the environmental profession, the assessment and certification of its peers.

The Institute brings to the CAMAC's attention that having certified or qualified environmental practitioners involved in CSR, whether it is through development of CSR reports, auditing or verification would ensure the quality of the outcome. It would also give transparency to the process and provide a level of assurance that an organisation is delivering its CSR promises.

The Institute sees the involvement of certified or qualified environmental practitioners as critical to ensuring that CSR is implemented well, by business and accepted by the wider community. The Institute offers the recommendation that CSR improvements would utilise experienced professionals and in particular, certified environmental practitioners. More information on the Certified Environmental Practitioner Program can be found at www.cenvp.org

6. Embedding CSR and sustainability into business education and certification

Embedding CSR and sustainability into business education is a longer-term matter because it trains future business leaders in CSR. Opportunities include:

- having CSR as a core unit in all business courses;
- offering CSR streams in under-graduate and post-graduate courses; and
- continuing professional development courses in CSR for existing business leaders.

The Institute points out that as CSR becomes a more commonplace aspect of business management there will be a need for knowledge and experience in CSR to become an aspect of certification for other practitioners in other fields of business. An example is the accounting profession and its certification; CPA. The Institute would be happy to discuss this matter further with the CAMAC Committee.

7. Support for the Operating & Financial Review that is used in the UK

The Institute accepts the Operating and Financial Review (OFR) approach adopted in the United Kingdom. In Australia this would provide the wider community, including non-government organisations, with the means to familiarise themselves with organisations' operations, their performance, their perceived environmental impact and their policies in regard to environmental, social and community issues.

However, the Institute draws attention to the need for an external verification process of such a process, if it were adopted in Australia. This would ensure that it was transparent and gave an objective and true view of the organisation's CSR position.

8. Use of the Global Reporting Initiative together with utilisation of certified environmental practitioners and public comparative list

The Institute accepts the use of the Global Reporting Initiative (GRI) and Sustainability Guidelines as a framework for corporate reporting. The Institute points out that GRI provides a phased approach towards Sustainability Reporting.

For the Australia Government to commence a staged approach it could develop a minimal set of core indicators for use in different industrial sectors and work with relevant professional bodies such as the Institute to develop an appropriate accreditation / training program to facilitate this rollout.

It is important that whatever indicators corporations use under the GRI, the non-financial component of a CSR report would need to be validated by certified practitioners in an appropriate field, just as financial statements are validated by chartered accountants.

Apart from awards, which are already used for corporate reporting, the use of a publicly available comparative list of company performance against agreed, standardised GRI indicators would need to be mandatory to provide sufficient incentive for change. Again, for reliability and transparency, the list would indicate whether the results are certified. This could take the form of the Sustainability Reporting Library managed by the Australian Government Department of the Environment and Heritage. The Institute acknowledges that this could only be put into action by revising current legislation.

Further Information

Further information on the Institute or any of the points raised in this submission can be obtained from John Ashe, Chair of the External Relations Committee, on (02) 6239 7835.

BILL HAYLOCK FEIANZ

PRESIDENT, ENVIRONMENT INSTITUTE OF AUSTRALIA & NEW ZEALAND

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Insurance Australia
Group Limited
ABN 60 090 739 923
388 George Street
Sydney NSW 2000
Telephone 02 9292 9222
iaglimited.com.au

IAG
Insurance
Australia
Group

21 February 2006

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

john.kluver@camac.gov.au

Dear Mr Kluver

Insurance Australia Group Limited welcomes the Corporations and Markets Advisory Committee's Corporate Social Responsibility *Discussion Pape*r and the opportunity to provide comments to the Advisory Committee.

I enclose a copy of our submission to the Parliamentary Joint Committee on Corporations and Financial Services on Corporations and Financial Services Inquiry into corporate responsibility and triple bottom line reporting for incorporated entities in Australia by way of written submission.

Should you require further information on any issues in this submission please do not hesitate to contact Pauline Gregg, Senior Manager, Corporate Social Responsibility, Corporate Sustainability Team on (02) 9292 9413.

Yours sincerely

Dr Barbara Carney
Group Head, Government Relations & Policy
Insurance Australia Group

EXECUTIVE SUMMARY

Perhaps the simplest and most effective articulation of the business case for corporate responsibility comes from the World Business Council for Sustainable Development, which simply states, “Business cannot survive in a society that fails”[1].

Insurance Australia Group’s (IAG) approach to corporate responsibility lies in the fundamental recognition that our business has impacts on the community, the environment and the wider economy; and that it is good business to operate in a way that recognises these impacts and responds to them effectively.

Michael Hawker, CEO of IAG, has articulated IAG’s position in simple terms: “Strong companies are sustained because they understand, and respond to changing customer and community priorities”.[2]

The core of IAG’s sustainability work is that we seek to deliver shareholder value by excellent management of our group of companies - for the long term. We actively make sustainability central to our core business by embracing opportunities and managing risks deriving from the full range of economic, environmental and social factors that interact with, and impact on, our operations every day.

IAG has taken considerable time and collective thought to interrogate and define it’s purpose, namely the role we play in the society in which we operate. Inherent in this debate has been our deep consideration of the extent to which our business decisions must have regard for our customers, our people, our shareholders and the broader community.

We acknowledge that our thinking in this area is continuing to develop and mature, as our understanding of our social licence to operate deepens and is informed and enriched by dialogue with our key stakeholders.

In essence, as an insurer with one in three households in Australia and New Zealand relying on IAG to protect them and their assets, we believe our purpose is to deliver value in four ways:

- *Paying Claims* – the very reason our customers pay premiums is peace of mind that comes with knowing that in times of loss, IAG will cover legitimate claims;
- *Understanding and Pricing Risk*- we do not underprice risk, putting our ability to pay claims into question, nor overprice risk, putting the affordability of insurance into question;

[1] *Sustainability Through the Market: Seven Keys to Success*, World Business Council for Sustainable Development, 2001
[2] *The Fewer The Risks The Better – For Everyone*, IAG Sustainability Report 2004 http://www.iag.com.au/pub/iag/sustainability/publications/report/2004/index.shtml

- *Managing our costs* - being as efficient as possible helps to reduce the costs of insuring risk; and
- *Reducing risk in the Community* – one of the greatest benefits IAG can provide to our customers and the broader community is to identify the very risks being insured and help to reduce them. Risks in this context covers road safety, crime, the environment (and climate change in particular), emergency services and workplace health and safety.

IAG initially spent over two years exploring and interrogating our corporate responsibility/sustainability approach before we decided to produce a sustainability report. We believe that we have developed some leading edge thinking in relation to the role of an insurer in society and we are receiving feedback in global forums that our work in relation to our supply chain and on climate change advocacy is new and inspiring and business focused.

IAG was the joint winner of an award by the Australian and NZ Association of Certified Chartered Accountants (ACCA) for Best First Time Reporter, Sustainability Reporting 2004. ACCA indicated that one of the key strengths of the report was the strong articulation of the business case for sustainability.

IAG continues to rate well in local and global corporate responsibility and sustainability indices, including the Corporate Responsibility Index and RepuTex Social Responsibility Rating, and we are included in the FTSE4Good Index.

Had we pursued our sustainability agenda from a compliance driven perspective, the outcome would have been very different.

IAG maintains that the essence of success in achieving full integration of stakeholder considerations into business decision making lies in the understanding that there is no “one size fits all” approach.

Success in owning and driving a corporate responsibility agenda lies in the effort that the company makes in exploring, debating and deciding how best it can integrate these considerations into its purpose and operations.

In pursuing such an approach, corporations have a very real opportunity to develop and implement agendas that are not only new and innovative, but which are relevant to their operations and which resonate with their employees. More importantly, it provides the opportunity for companies to understand the approach that will take account of stakeholder interests in a way that adds value to their business.

IAG believes that attempting to regulate corporations in this regard has the following potential problems:

- The practical difficulty in prescribing directors duties that can apply across a range of sectors and markets (one size does not fit all);
- How to define the actual desired outcomes of a regulatory framework and the means for achieving them;
- The risk of creating compliance driven cultures within organizations, which inevitably leads to a failure of integrating responsible behaviour into the business.

IAG considers that corporate responsibility within Australia is still an emerging practice and introducing some form of obligation on companies to consider or report on corporate responsibility activity could artificially speed up or terminate new and emerging approaches before they have an opportunity to prove successful or otherwise.

Further, IAG believes that consideration of appropriate mechanisms to drive integration of corporate responsibility principles in companies should not underestimate the power of markets in influencing and shaping corporate behaviour.

Increasing numbers of institutional investors are requesting and requiring disclosure and transparency on the broad range of social and environmental issues related to a company's operations.

IAG believes that investor activity and market demands, combined with complementary government policies and frameworks provides enormous potential to encourage companies to adopt a corporate responsibility approach. There is therefore a pivotal role for government in corporate responsibility, and it need not involve mechanisms regulating corporate activity. In particular, government has two major roles:

- To demonstrate leadership in its own activity to encourage corporate responsibility and sustainability across all sectors; and

- Providing an environment where companies are encouraged to create innovative corporate responsibility and sustainability approaches by providing for flexibility, competitive and market-led developments.

IAG believes that meaningful dialogue on the desired outcomes of all sectors in pursuing a mutually acceptable corporate responsibility agenda will achieve strong outcomes. Most importantly, it presents an opportunity to create a flexible operating framework that encourages companies to explore, debate and decide how best to integrate these considerations into their operations.

Adoption of such an approach in Australia could build on the lessons already learnt in the European Union and has the potential to establish Australia's credentials as a leading force in corporate responsibility.

In the 2004 Dow Jones Global Sustainability Index, Australia ranked top in the category of corporate governance[3]. This presents a strong platform from which Australian business could develop a leading corporate responsibility strategy where corporate governance and practices are aligned with stakeholders' expectations on environmental protection and social process, as well as economic performance.

Clearly there are strong opportunities for government and business to develop a policy framework that will encourage companies to build long-term shareholder value and grow social capital for Australia.

INTRODUCTION

Insurance Australia Group Limited (IAG) welcomes the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into corporate responsibility and triple bottom line reporting for incorporated entities in Australia.

Who is Insurance Australia Group?

IAG, a publicly listed and Australian owned company, is the parent company of the largest general insurance group in Australia and New Zealand. It provides personal and commercial insurance products under some of the most respected and trusted retail brands including NRMA Insurance, SGIO, SGIC, CGU and Swann Insurance in Australia, and State and NZI in New Zealand.

IAG's core lines of business include:

- Home insurance
- Motor vehicle insurance
- Business insurance
- Consumer credit insurance
- Product liability insurance
- Compulsory third party (CTP) insurance
- Workers' compensation insurance
- Professional risk insurance

[3] www.sustainability-indexes.com

IAG has a crucial interest in the long-term viability of insurance as a product valued by the Australian community. IAG believes that there are four principal ways in which the insurance industry can best meet these objectives. These are:

- Investing in robust risk control frameworks and mechanisms that protect policyholders and provide certainty to shareholders;
- Pricing products realistically;
- Ensuring that customers understand what they are buying when they purchase a policy, and that products do not arbitrarily advantage or penalise particular individuals or groups; and
- Committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that facilitates more affordable premiums and more predictable claims costs.

Corporate Responsibility - definition

In making this submission to the Inquiry, it is important at the outset to deal with the issue of definitions and terminology used to explain corporate responsibility and to define the rationale that underpins IAG's approach. This is particularly important given the lack of a broadly accepted definition in Australia and indeed globally. This is also reflected in the absence of a definition of "corporate responsibility" in the Inquiry's Terms of Reference.

Corporations across the globe use a variety of terms and definitions to describe their business approach to corporate responsibility. The myriad of terms includes Corporate Social Responsibility, Corporate Sustainable Development, Corporate Responsibility, Triple Bottom Line and Corporate Sustainability. The lack of a globally defined term continues to cause some confusion for corporations in considering pursuit of such an agenda, especially those in the initial stages of formulating a corporate responsibility approach.

Many corporations globally have chosen to articulate acknowledgement of their responsibilities to a broad range of stakeholders throughout society including employees, customers, business partners, communities and the environment. Insurance Australia Group is one of those companies. We define our stakeholders as those who have the greatest "value impact" relationship with IAG – in other words, those who impact on our activities and those who are impacted by our activities, either directly or indirectly.

IAG believes that use of the term "responsibility" carries a connotation of compliance that potentially limits the range of innovation and opportunities that companies can embrace and harness in a sustainable business approach.

IAG prefers instead to use the term “sustainability” because it better reflects our fundamental belief that strong companies are sustained and will continue to operate and grow into the future because they understand, and respond to, changing customer and community priorities.

IAG seeks to deliver shareholder value by excellent management of our group of companies for the long term. We are a publicly listed company on the Australian Stock Exchange with almost 1 million shareholders, many of who are retail investors. We consider sustainability to be central to the way in which our core business is delivered and that we can create *enhanced long-term shareholder value* by embracing opportunities and managing risks deriving from the full range of economic, environmental and social factors that interact with, and impact on, our business every day.

Because of our view of sustainability, IAG has a corporate objective of competitive differentiation and market advantage based upon being an organisation aligned around social, environmental and ethical responsibilities. This objective is explicitly acknowledged by the IAG Board.
For the purposes of this submission, the term ”corporate responsibility” (CR) will be applied to ensure consistency across the Inquiry’s deliberations.

Terms of Reference

The extent to which organisational decision makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

The extent to which organisational decision makers should have regard for the interests of stakeholders other than shareholders, and the broader community

IAG's Approach

Perhaps the simplest and most effective articulation of the business case for corporate responsibility comes from the World Business Council for Sustainable Development, which simply states, "Business cannot survive in a society that fails"[4].

IAG recognises that our business has impacts on the community, the environment and the wider economy. If fact, we believe that it is good business to operate in a way that recognises these impacts and responds to them effectively.

We have made publicly available on the IAG website (www.iag.com.au) a series of Statements of Commitment that articulate our ***business commitment to our stakeholders***. There are three central Statements:

- Statement of Commitment to Sustainability
- Statement of Commitment to the Environment
- Charter for Health, Safety and Security

Copies of these Statements are provided in Attachments A-C for the Parliamentary Committee's information. IAG's position in those Statements can be summarised as follows:

- We acknowledge that the sustainability of our business is directly tied to the sustainability of the communities in which we operate;
- We consider that returns to our shareholders, and the company's own stability and growth potential, will be enhanced by us conducting our business in a way that creates value for society on numerous fronts, across environmental, social and economic dimensions;

[4] *Sustainability Through the Market: Seven Keys to Success*, World Business Council for Sustainable Development, 2001

- We believe this because running a successful business, including having access to the capital and community support that we need to grow, is the best way for us to meet our commitments to our shareholders, our customers and our people;
- We have identified our key stakeholder groups and IAG has publicly acknowledged our belief that ongoing stakeholder dialogue is essential for us to respond to the expectations of the community in which we operate; and
- We welcome dialogue with our stakeholders and consider it is an essential component of our commitment to continually improve our practices and operations. We strive to build meaningful relationships with our stakeholders primarily thorough engagement and partnerships.

IAG's commitment to sustainable business practice originates at the Board level. The Board's Nomination, Remuneration & Sustainability Committee holds responsibility for providing oversight on how IAG ensures it acts with a high standard of social, environmental and ethical responsibility in all its areas of operation (the Committee's Terms of Reference are provided in Attachment D)

Other specific responsibilities of the Board's Committee include:

- Consideration and review of the social, environmental and ethical impacts of IAG's business practices and review the appropriateness of the standards set by management for social, environmental and ethical practices;
- Consideration and endorsement of management initiatives to achieve IAG's corporate objective of competitive differentiation and market advantage based upon being an organisation aligned around social, environmental and ethical responsibilities;
- Monitoring how effectively the views of IAG's key stakeholder groups (people, customers, community and shareholders) are considered; and
- Monitoring compliance with IAG's published social, environmental and ethical responsibility policies and practices and the level of their integration into the business.

The Role of IAG in Society

Integrating stakeholder interests in our values, purpose and business operations

IAG has taken considerable time and collective thought across the organisation to interrogate and define its purpose, namely the role we play in the communities in which we operate. Inherent in this debate has been our deep consideration of the extent to which our business decisions must have regard for our customers, our people, our shareholders and the broader community.

We acknowledge that our thinking in this area is continuing to develop and mature, as our understanding of our social licence to operate deepens and is informed and enriched by dialogue with our key stakeholders.

Our initial thinking centred on the role of insurance as a community product. The origins of the insurance business lie in meeting a societal need that individuals and small groups cannot address on their own. In IAG's view, insurance is based on the community value that it is more economic and fulfilling to pool effort, resources and interdependencies to lead a life that is long, enjoyable and less risky than it would be otherwise.

To best manage risk, communities all over the world use some type of insurance.

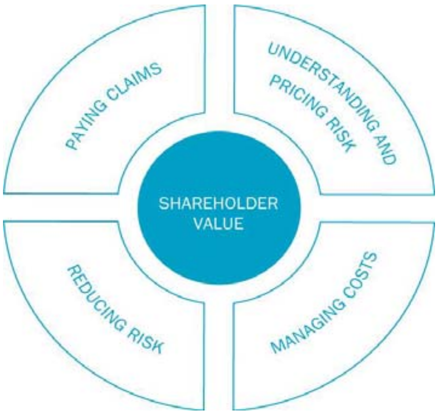
The community generally reduces those risks by insuring against personal accidents and mishaps or natural phenomena, such as fires or storms. Individuals and communities set aside money and pool it. If a personal accident or natural disaster occurs, the pool of funds is used to help them recover, repair or rebuild.

As IAG has further considered the value proposition of insurance as a community product, we have deepened our understanding of what the community expects of us. As an insurer with one in three households in Australia and New Zealand relying on IAG to protect them and their assets, we believe our purpose is to deliver value in four ways:

- Paying Claims
- Understanding and Pricing Risk
- Managing our costs and
- Reducing risk in the Community

These are the four central elements of activity that IAG must deliver well to fulfil our role in society.

IAG recognises that our purpose involves a complex interconnection and linking of IAG's role and responsibilities to all our stakeholders, with specific emphasis on customers, shareholders, our staff, our business partners, the environment and the community generally.



Paying Claims

Customers expect their claims will be paid. That is the point of insurance. However, IAG believes we must also ensure there is no misalignment between what we pay our customers when they claim and what they perceived we would pay when they initially entered into the policy.

While this aspect of our purpose has greatest relationship to customers as a key stakeholder, there are broader impacts on a range of stakeholders. In managing claims, IAG's work also lies in quickly getting customers back to their normal way of life so they do not suffer hardship and in turn do not negatively impact on others. This in turn supports a society that collectively suffers minimal loss from events that have the potential to destroy societal value.

For example, in the case of workers' compensation, getting people back to work as quickly as possible assists them to resume their normal working life and the income and lifestyle that they expect and have worked hard to achieve. In doing so, the community benefits from less dependence on supporting social services, the employer reduces operating costs and governments are able to maintain and improve workers' compensation schemes within their jurisdictions.

During 2004-05, IAG paid out around $4.2 billion in claims, equating to approximately $11 million per day.

Understanding and Pricing Risk

Insurers price products before their full cost is known. It is therefore imperative that they are expert in assessing and pricing risk accurately and fairly.

The challenge for insurers is to price the risk, ensuring it is neither overpriced nor underpriced. The collapse of HIH Insurance clearly demonstrated that underpricing risk seriously jeopardises the long-term viability of an insurance company and its capacity to always be around to pay claims.

In support of this purpose, IAG employs a range of specialists such as industry researchers, atmospheric scientists, underwriters and actuaries, who collect and analyse data relating to risks.

While this plank of IAG's purpose may initially be considered to relate primarily to customers, the broader community and societal impacts of inappropriately priced insurance are significant.

If risk is priced too highly, people will not take out insurance and in the instance of catastrophe; the loss to the individual and the consequent demand on community resources will be significant. The 2003 Canberra bushfires provide a strong example of the potential economic and social impacts of non-insurance. In cases where those who did not insurance suffered property loss, there was significant personal hardship. There was a strong community impact in that local neighbourhoods and communities took longer to rebuild and there was an additional cost to government in providing assistance to those victims (Government support was $10,000 for insureds and $5,000 for non-insureds).

Conversely, the underpricing of risk has consequences. It was not just the customers of HIH Insurance that were impacted by the company's collapse. Its employees, supply chain, and customers of HIH's policyholders (for example Builder's Warranty insurance) all suffered loss. Not only were governments called upon to financially assist those suffering most loss, government resources were required to investigate the collapse and set in train regulatory regimes to prevent recurrences. IAG maintains that this would not have been necessary had the company in question acted responsibly. Indeed, Parliamentary Library Paper (2001) *HIH Insurance Group Collapse* provides details of the action taken by various jurisdictions to address the HIH issue. Details are outlined below.

HIH Insurance Collapse & Government Assistance Packages

	Rescue package funded by	HIH collapse exposure
NSW	Insurance protection tax	$600 million
VIC	Building industry levy & Government	$70-$80 million
QLD	$5 levy a year for compulsory third party	$400 million
WA	**5% levy on workers' compensation premiums**	**More than $93 million**
SA	No rescue package	No figure given
TAS	Levy on workers' compensation premiums	More than $50 million
ACT	3% levy on workers' compensation premiums	$30 million
NT	Government provided $3 million for workers compensation to last 3 months	$40 million
FEDERAL	Federal Government package	$640 million

Source: Parliamentary Library, (June 2001), HIH Insurance Group Collapse, Current Issues.

Managing our Costs

An insurer's operating costs are included in the price of a premium. IAG considers it must be efficient as possible to keep costs down so as to minimise this component in premium prices. The economics of IAG's business are based on scale, which allows access to volume across the supply chain, without sacrificing quality. IAG is responsibly using our scale to keep our costs per policy down.

IAG is now exploring how we might take this further – how our scale could best be utilised to influence and benefit the broader range of IAG's stakeholders. This requires understanding of long-term shareholder value that can be derived from integrating such an approach into short-term financial imperatives (such as costs).

For example, IAG understands that its long term business will be impacted by human induced climate change, typified by an increase in the frequency and ferocity of weather events that will result in increased insurance claims and payouts. IAG is addressing how it might best leverage its scale with its supply chain to address the primary cause of climate change, greenhouse gas emissions. The use of IAG's scale could assist in leveraging outcomes that both increase awareness of the impacts of climate change and assist in reducing greenhouse gas emissions.

Reducing Risk in the Community

Insurers and the community alike benefit from reducing the likelihood of a claim from occurring in the first place. None of us wants to experience the hardship that leads to making a claim, so IAG uses its data and knowledge to help reduce the likelihood of a claim occurring in the first place. IAG concentrates on reducing environmental risks, crime and workplace injury.

IAG understands that there is mutual benefit for all our stakeholders in working to reduce risk in a fashion that does not discriminate against non customers.

Examples of IAG's work which best demonstrate this principle are:

- Simple advice to the general community (by way of a media release) at the commencement of a holiday period on steps to protect property while people are on holiday – we do not discriminate with this advice to customers only as we believe the societal benefits to all are strong;

- IAG's Technical Research Centre collaborates with leading motor vehicle manufacturers and provides advice and feedback on their design, particularly safety features. The resultant change not only reduces IAG's claims costs, it provides for the manufacture and design of safer vehicles, benefiting the community generally;

- IAG has shared its motor vehicle research through the launch of the Greensafe Car Profiler – a web based tool on all IAG's retail brand websites – which rates motor vehicles on safety and environmental performance; and

- Use of IAG's claims data to identify high-risk areas for accident and safety within the home and integration of that information into Help House, an interactive web based portal on all IAG's retail brand websites to assist people to make their homes safer.

For further information on IAG's work to share our knowledge to reduce risk, please see pages 10 and 11 in the IAG 2004 Sustainability Report.

The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community

As a listed company, IAG believes that the current legal framework, the function of investment markets and media/stakeholder interest, combine to provide an appropriate incentive for our directors (and directors of the companies which we insure and in which we invest) to have regard for a wide range of stakeholder interests, while ensuring that the interests of investors are protected.

We believe that directors have the freedom, and often even the mandate, to take the interests of stakeholders into account, provided that there is a commercial justification for doing so. The range and nature of stakeholder interests to be taken into account will vary widely from company to company, and from time to time for a particular company.

While the promotion of the interests of the company as a whole must still be the primary focus of directors, there appears to us to be nothing in the relevant legislation or case law which operates to discourage directors from having regard to the interests of other stakeholders. IAG argues that the integration of the interests of stakeholders in fact improves the quality of director's deliberations and can indeed be a source of competitive differentiation and market advantage.

Directors do not, in our experience, generally define their obligations narrowly, or focus on shareholder returns at the expense of all other stakeholders. Having regard to stakeholders' broader interests is vital for the long-term interests of the company and its sustainability. The exclusive pursuit of short-term returns for shareholders may turn out to be counter-productive in the longer term, thus circumstances may warrant incurring a short-term cost that benefits some stakeholders provided the directors are satisfied that this is outweighed by the long-term sustainable benefits what will ultimately flow to shareholders as a result of incurring that cost.

In IAG's view, each company is best placed to identify which interests should be taken into account, and how best to do so. As we have seen recently, companies that fail to take relevant stakeholder interests into account potentially risk negative reaction from stakeholders, community groups, the media and government. They also have the potential to destroy shareholder value. These are powerful factors, and it is arguable that directors would already risk breaching their duties if they failed to give due regard to such interests or to give regard to the interests of shareholders to the exclusion of such interests.

Each company's stakeholders are so diverse and prone to change that it would be extremely difficult to prescribe new directors' duties, even if high level principles were adopted. For the same reasons, we believe that prescribing a particular form of disclosure would also be unworkable, and could encourage companies to adopt a "tick the box" approach, rather than address the underlying issues.

There is a body of existing legislation, regulations, guidelines and recommendations that sit alongside the basic directors' duties (as set out in the Corporations Act and in relevant case law) and operate to safeguard a wide range of stakeholders' interests. These include the "if not, why not", disclosures required of its ASX listed companies by the ASX Principles of Good Corporate Governance and Best Practice Recommendations (in particular Principle 10, which says that companies should establish and disclose a Code of Conduct to guide compliance with its obligations to "legitimate stakeholders"). Directors must also ensure compliance with a broad range of legislation covering, among other things, environmental protection, OH&S, trade practices and consumer protection.

We believe that the challenge now is to keep such legislation and regulation relevant to meet the ever-changing interests of stakeholders, and for directors to ensure compliance with it, while appreciating fully the impact that their actions may have on the interests of stakeholders and the sustainability of their companies.

Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering the matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

For the reasons set out above, IAG believes that there is currently no need to amend the existing legal framework to enable or encourage directors to have regard to broader interests.

Although IAG notes that the question relates to “enable or encourage” companies and directors to have regard for the interests of non-shareholder stakeholders and the broader community, it is worth commenting briefly on the downsides of implementing change that made it mandatory to give such consideration.

Directors are currently, through the operation of case law and the *Corporations Act*, bound to their duties to the company, and to the shareholders as a whole. This test provides an adequate and judicially well-tested statutory framework, originating under the common law, within which to make decisions. Some case law and commentators have recently hinted at an erosion of such a test such that other stakeholders may be factoring into this consideration.

There are also significant laws imposing direct or derivative liability on directors in such areas as workplace safety and the environment.

Beyond those laws currently in place, we believe that the Government should not consider implementing legislation that *requires* directors or companies to take into account matters beyond those already established. To do so would have the real potential to throw directors’ duties into chaos, as they would frequently be unable to effectively balance the needs of the company with those of a stakeholder, or even balance an interest amongst multiple stakeholders where those interests are irreconcilable or otherwise would give rise to inconsistent outcomes.

Effectively, if the company and its shareholders as a whole are the primary stakeholders whose interests are preferred, the cumulative effect of current expectations and power of stakeholders such as consumers, regulators, the media, courts and others will likely be properly factored into key decisions.

Maintaining the status quo would thus avoid higher risks of litigation against companies and their directors, and ensure that many highly experienced competent directors did not withdraw from the available pool due to potential expectations and liability being too high. It would also ensure that Directors’ & Officers liability insurance has the best chance of being both attainable and affordable.

Any alternative mechanisms, including voluntary measures, that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

There are a number of global standards and mechanisms that apply to corporate responsibility. The application and relevance of these standards to corporate operations varies significantly.

The major international standards applying to companies have been identified by KPMG in its 2005 International Survey of Corporate Responsibility Reporting[5] and are listed as follows*:

Global Compact
UN Declaration of Human Rights
Equator Principles
Other UN Declarations
AA1000
Sullivan Principles
ILO
OECD Guidelines for Multinational Enterprises
SA8000
ICC Business Charter
Responsible Care

*The Global Reporting Initiative was not identified in this list as it is regarded as a specific standard for Corporate Responsibility reporting**.** _Specific discussion on the GRI follows in detail in Reference (f) in this submission._

The application and relevance of these standards varies significantly. Some standards encompass a very broad range of stakeholder interests, for example the OECD Guidelines for Multinational Enterprises cover a broad spectrum of stakeholder interests and concerns ranging from human rights to environmental management, competition, consumer interests and corporate disclosure. Other standards are specifically aimed at the interests of particular stakeholder groups – for example the core labour standards of the International Labour Organisation, apply to employees only.

Some are sector specific, such as the Equator Principles that apply to the finance sector. Some require active commitment and promotion from those with “signatory status” whereas others serve to provide a reference point for corporations to identify, consider and possibly benchmark local or global stakeholder interests.

[5] http://www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf

It is worth noting that the majority of these standards have been formulated for global application and this is in keeping with the KPMG observation that "…the CR movement as indicated by reporting is led primarily by multinational (G250) corporations rather than by other national influences".[6] This also supports the finding that of the global CR reports examined; most refer to the standards established by the United Nations System followed by the OECD Guidelines. Management frameworks such as SA8000 or AA1000 were found to play a relatively marginal role in CR reporting.

It is clear that the challenge arising from the variety of standards currently available lies in the view that "one size fits all" is not an appropriate approach to guide companies undertaking a corporate responsibility agenda. Some companies operate globally, some nationally, others locally. In each case and across sectors and industries, the stakeholders are different and their levels of impact differ significantly across operations. Accordingly, IAG accepts that there is a need for a range of standards that apply to differing aspects of corporate operations on corporate responsibility.

IAG considers the greatest strength of these standards lies in the fact that they are voluntary. Companies that choose to apply, sign up to, support and comply with these standards and mechanisms do so because they recognise their value; and they are relevant to their business, rather than being required to comply with them. Commitment by companies to the standards promotes a "centre of excellence" where the benchmark for corporate responsibility and the consideration of the wide range of stakeholder interests continues to improve and mature as companies adopt innovative approaches.

The standards and mechanisms also serve as a useful point of reference for those companies contemplating a corporate responsibility approach – they allow companies to benchmark, explore, understand what is important to stakeholders and translate how they might engage and respond to their local and key stakeholders if those issues are relevant to both their business and their sphere of operation.

Given that IAG's operations have in the past largely been in Australia and New Zealand, our adoption of the range of global standards has been limited. We have not yet dealt with the corporate responsibility issues and standards that provide greater levels of guidance for global organisations, particularly those operating in developing countries and emerging economies.

However, given IAG's commitment to growth in Asia and as we move to become a truly global organisation with interests outside Oceania, we are building capacity around the corporate responsibility issues that we will face as a multinational organisation and investigation of those mechanisms and standards is part of our work in building our capability. We will strive to participate in, and strongly support, standards and voluntary mechanisms that will enable IAG to better understand the interests of stakeholders in our potential global operations.

[6] http://www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf

One of the first actions IAG has taken in this regard was to become a signatory to the United Nations Environment Program Finance Initiative (UNEP FI) a partnership between global finance sector organisations and UNEP to promote sustainable business in the finance sector. IAG is active in the Initiative, holding an elected position on the global Steering Committee of UNEP FI.

The appropriateness of reporting requirements associated with these issues.

In terms of corporate responsibility reporting, the Sustainability Reporting Guidelines of the Global Reporting Initiative (GRI) are now well established and recognised as the International standard for reporting on corporate responsibility performance. According to the GRI, 707 companies currently report on the basis of the Guidelines [7]. In contrast to the standards and mechanisms that guide management of Corporate Responsibility issues, the GRI Guidelines are largely applicable to organisations across all sectors, whether they are national or multinational operations.

However, at the same time, the GRI is also working to progressively ensure the guidelines are appropriate to sectors with the development of sector supplements.

In reporting for the first time in 2004, IAG chose to measure and report our activities against the GRI framework for sustainability reporting. The GRI indicators which IAG reported can be found at Page 32 of the 2004 Sustainability Report "The Fewer the Risks the Better – For Everyone".

IAG is a strong supporter of the GRI framework and considers it is an appropriate standard for corporate responsibility reporting. Its wide acceptance amongst corporations globally is warranted; and IAG considers it should be accepted as the international standard for CR reporting.

IAG is an organisational stakeholder of the GRI and is an active participant in its global work program. Since 2003, a senior member of IAG's Sustainability Team has been a member of a joint working group established by UNEP FI and the GRI to develop a Finance Sector Supplement to the GRI for environmental indicators.

IAG considers that there are strong benefits in using the GRI Guidelines. From our Group's perspective, the most important aspect is that the Guidelines were developed through a global multi-stakeholder consultative process. The environmental, social and economic performance indicators (that have become the main staple of the Guidelines) were agreed by stakeholders to be the most important and relevant measures that companies should report their performance against.

[7] www.globalreporting.org

This provides IAG with a level of confidence that the indicators within the guidelines are at the very least, a viable starting point for engagement with our own key stakeholders on sustainability reporting for IAG's operations.

Further, the work of the GRI involves active participation of representatives from a broad range of stakeholder groups – including representatives from business, investment, human rights, research and labour organisations from around the world[8]. Accordingly, the ongoing multi-stakeholder process has ensured that GRI indicators contained in sector supplements are current, relevant and important issues for stakeholders.

IAG considers that the standardisation of indicators in the GRI assists organisations to benchmark performance within and across sectors.

One of the central features of the GRI Guidelines is the fact that participation is voluntary and organisations are permitted to report against any or all of the indicators. The flexibility in the number of indicators to be reported allows an organisation to build capability over time. In a practical sense, companies that have not previously measured social and environmental performance need time and resources to build and manage the systems that will enable them to measure, benchmark and improve performance across non-financial dimensions.

In our first report, IAG chose to measure and report performance against 26 GRI Indicators. We consider that over time, as the issues of importance to our stakeholders continue to inform our work, we will build capacity to improve our reporting and to increase our internal recognition of the importance of non-financial data in the organisation's overall performance.

[8] www.globalreporting.org

Whether regulatory, legislative or any other policy approaches in other countries could be adopted and adapted for Australia

IAG does not currently operate in any overseas markets where there are regulatory or other policy approaches in respect of corporate responsibility. Accordingly, commentary in this section is based on IAG's research, observations and collaboration with global peers in the corporate responsibility field.

International Precedents

Companies in the European Union and the UK are generally considered to be the most advanced in terms of Corporate Responsibility practice and reporting. Companies from these markets consistently continue to dominate top rankings in the Dow Jones Global Sustainability Index.

There has been activity in the European Union and its separate national Governments to advance the CSR agenda over the last five years and in the United Kingdom, there have been a series of initiatives to promote a CR framework for business, including the creation of the Minister for Corporate Social Responsibility.

It is interesting to note that while these markets all promote corporate responsibility, the extent to which it should be regulated remains subject to debate. The European Multi-Stakeholder Forum on CSR, chaired by the European Commission failed to reach agreement on the extent to which CSR should be incorporated into the regulatory environment and fell short of recommending mandatory reporting, calling instead for "ensuring an enabling environment for CSR".[9] There are apparently no plans by the EU to further pursue the issue of mandatory Corporate Responsibility reporting.

In terms of those member countries that have introduced mandatory reporting requirements, it seems that the "jury is still out" on the effectiveness of those reforms in that most of the legislative changes have only been implemented recently, with Germany and Finland being examples.

Perhaps the most established legislation in this regard is the French NRE Law, which has been in operation since 2001. IAG's research on this legislation reveals conflicting views on its success. Criticisms of the law relate to the difficulty in securing agreed indicators, the question of external certification or auditing, and the cost of reporting.

In the UK, the proposal to include social and environmental considerations in the Operating and Financial Review remains subject to consultation.

[9] European Multistakeholder Forum on CSR – Final Results & Recommendations 2004, linked from http://www.euractiv.com/Article?tcmuri=tcm:29-128631-16&type=News

While there are no current proposals to require companies in Australia to report on their environmental and social performance, IAG does not believe that regulatory approaches will necessarily produce the desired outcomes for governments and society.

IAG maintains that the essence of success in achieving full integration of stakeholder considerations into business decision making lies in the understanding that there is no “one size fits all” approach.

Success in owning and driving a corporate responsibility agenda lies in the effort that the company makes in exploring, debating and deciding how best it can integrate these considerations into its operations.

In pursuing such an approach, corporations have a very real opportunity to develop and implement agendas that are not only new and innovative, but which are relevant to their operations and which resonate with their employees. More importantly, it provides the opportunity for companies to understand the approach that will take account of stakeholder interests in a way that adds value to their business.

IAG initially spent over two years exploring and interrogating our corporate responsibility/sustainability approach before we decided to produce a sustainability report. We believe that we have developed some leading edge thinking in relation to the role of an insurer in society and we are receiving feedback in global forums that our work in relation to the supply chain and on climate change advocacy is new and inspiring.

IAG was the joint winner of an award by the Australian and NZ Association of Certified Chartered Accountants (ACCA) for Best First Time Reporter, Sustainability Reporting 2004. ACCA indicated that one of the key strengths of the report was the strong articulation of the business case for sustainability.

IAG continues to rate well in local and global corporate responsibility and sustainability indices, including the Corporate Responsibility Index and RepuTex Social Responsibility Rating, and we are included in the 2005 FTSE4Good Index.

Had IAG pursued this agenda from a compliance perspective, the result may have been different. IAG considers that corporate responsibility within Australia is still an emerging practice and introducing some form of obligation on companies to consider or report on CR activity could artificially speed up new and emerging approaches before they have an opportunity to prove successful or otherwise.

It is interesting to note that the KPMG survey on CR reporting[10] indicates that there reporting of CR performance is quickly moving away from compliance related disclosure of quantitative data to the reporting of relevant information that is material to the organization’s key stakeholders and decision makers.

[10] http://www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf

The Influence of Markets

Discussion about appropriate drivers of CR performance in companies should not underestimate the power of markets in influencing and shaping corporate behaviour.

Increasing numbers of institutional investors are requesting and in some cases, requiring, disclosure and transparency on the broad range of social and environmental issues related to a company's operations.

The underpinning of this approach lies in the acceptance by investors that integration of CR issues in a company can reduce operational costs, minimise unexpected losses and enable companies to foresee and more effectively manage long-term global trends. Two notable examples are:

- The Carbon Disclosure Project which globally represents over 140 institutional investors with assets of $20 trillion (US dollars) who consider potential risks and opportunities stemming from climate change should be assessed in portfolio selection. The investors collectively approach the world's 500 largest quoted companies by market capitalisaton, requesting information about the extent the company has integrated carbon risk into their operations.

- The US based Investor Network on Climate Risk, formed in November 2003, comprising over 40 members representing $2.7 trillion of assets mainly representing public pension funds, state treasurers and religious institutional investors. The Network seeks to promote investor and corporate engagement and understanding of the range of risks posed by climate change.

According to a recent Portfolio Strategy report released by Goldman Sachs, while environmental issues have previously been confined to Socially Responsible Investing (SRI), they now pose potential risks and opportunities for almost every company and they come with financial implications as well. The report "*The interest in environmental issues is important to both socially responsible and fundamental investors*"[11] indicates that environmentally related issues are now an important theme for fundamentally based investors and should not be confined to the SRI industry.

IAG considers that market forces serve as a powerful and healthy driver of corporate behaviour. Investor demands can influence a company to consider and integrate corporate responsibility; while at the same time those demands can be flexible enough to enable a company to tailor its approach in a way that meets the demand yet suits the company's operation and culture. The implications of not responding to investor requirements resonate strongly with companies in a manner that has the potential to drive company performance more effectively than a compliance-based approach.

[11] www.gs.com/research/hedge.html

The Role of Government

IAG believes the combination of investor activity and market demands with complementary government policies and frameworks provides enormous potential to encourage companies to adopt a CR approach. There is therefore a pivotal role for government in corporate responsibility, and it need not involve mechanisms regulating corporate activity. In particular, government has two major roles:

- To demonstrate leadership in its own activity to encourage CR and sustainability across all sectors; and
- Providing an environment where companies are encouraged to create innovative Corporate Responsibility approaches by providing for flexibility, competition and market-led developments.

In practical terms, there is significant potential for a whole of government approach to drive CR activity. Currently, a limited number of government agencies have specific agendas to drive some CR and related activities. In the Commonwealth, examples include the Department of Environment and Heritage, the Department of Family and Community Services and the Australian Greenhouse Office, which all deliver a variety of programs aimed at providing incentives for corporate responsibility activity. Many of those programs have been successful, due to the commitment and leadership from those agencies. However, one of the problems for the private sector in the past has been that in many cases, government programs rarely have a long life and industry often faces new programs every few years

IAG considers there is significant opportunity for activity across government to be better coordinated. For example, the power of influence of government agencies in implementing social and environmental considerations into procurement policy presents an opportunity for government to lead.

Further, taxation reform remains a vital opportunity for government to implement taxes and pricing as incentives for sustainability and corporate responsibility action by business. As one example, the current FBT rules encourage increased road usage instead of providing incentives to reduce motor vehicle usage.

In terms of providing an environment that encourages corporate responsibility by companies, actions that government could undertake are broad ranging, including:

- Educating companies and the public about corporate responsibility issues
- Assistant for research and development of new tools to assist companies to embrace corporate responsibility initiatives;
- Provision of incentives which encourage improved social and environmental performance;

There is no doubt that the private sector has much to offer government and vice versa. IAG believes that meaningful dialogue on the desired outcomes of both sectors in pursuing a mutually acceptable corporate responsibility agenda will achieve strong outcomes. Most importantly, it presents an opportunity to create a flexible operating framework that encourages companies to explore, debate and decide how best to integrate these considerations into their operations.

Conversely, it provides an opportunity for the private sector to raise issues where leadership is required from government.

Adoption of such an approach in Australia could build on the lessons already learnt in the European Union and has the potential to establish Australia's credentials as a leading force in corporate responsibility. It is interesting to note that in reporting the results of the 2004 Dow Jones Global Sustainability Index, Australia ranked top in the category of corporate governance[12]. This presents a strong platform from which Australian business could develop a leading CR strategy where corporate governance and practices are aligned with stakeholders' expectations on environmental protection and social process, as well as economic performance.

Clearly there are strong opportunities for government and business to develop a policy framework that will encourage companies to build long-term shareholder value.

Australia is not unique in debating the merits of regulation and government involvement in corporate responsibility and the debate continues across international markets.

An appropriate concluding comment is provided in the current article in *Ethical Corporation,* examining why mandatory CR reporting has fallen from the EU agenda:

"Whether regulation is a good or a bad thing, one thing that most corporate reporters agree on is that corporate social responsibility reporting has been useful in enabling organisations to step back and assess how their actions affect their reputation, their labour environment and consumer perceptions. This in itself has conferred on these companies a competitive edge. With this in mind, companies and politicians might do well to remember that business introspection, however, stimulated, can spur rather than hinder growth"[13].

[12] www.sustainability-indexes.com

[13] *Europe: Why mandatory reporting has fallen from the EU agenda*, Ethical Corporation, 30 August 2005. www.ethicalcorp.com

Attachments

A. IAG Statement of Commitment to Sustainability - http://www.iag.com.au/pub/iag/sustainability/media/IAGcommitmentDec03.pdf

B. IAG Statement of Commitment to the Environment - http://www.iag.com.au/pub/iag/sustainability/media/environmentDec03.pdf

C. IAG Charter for Health, Safety and Security http://www.iag.com.au/pub/iag/sustainability/media/IAG-OHS-Charter.pdf

D. Terms of Reference, IAG Nomination, Remuneration and Sustainability Committee of the Board http://www.iag.com.au/pub/iag/CorpGov/media/NRSCC20050307.pdf

E. IAG Sustainability Report 2004 “The Fewer the Risks, the Better – For Everybody http://www.iag.com.au/pub/iag/sustainability/publications/report/2004/index.shtml

FSU
AUSTRALIA
www.fsunion.org.au

Dr Anthony Marinac
Acting Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600
corporations.joint@aph.gov.au

Dear Dr Marinac

Inquiry into Corporate Responsibility

The Finance Sector Union of Australia (FSU) welcomes the opportunity to contribute to the inquiry into Corporate Responsibility.

The FSU represents 60,000 members employed in the finance sector across Australia. Our interest in corporate responsibility stems from our members' interest in working in soundly managed, accountable and sustainable companies and ensuring that the interests of all stakeholders are considered by directors.

We have seen first hand the impact on employees when companies fail. One thousand finance industry workers were directly affected by the HIH collapse. Our members' difficult experience of working within a company with such inadequate corporate governance practices demonstrates to us the fact that good corporate governance is as much an issue for stakeholders as it is for shareholders.

Unfortunately the need to encourage and broaden corporate responsibility in Australia is nowhere better exemplified than in the finance industry, and not solely because of the HIH disaster. Many scandalous examples of management incompetence exist within the finance industry with members having to pay the price, (ie NAB's disastrous acquisition of Homeside which created a $4billion hole in the balance sheet and resulted in hundreds of jobs being shed, George Trumbull and Paul Batchelor's destruction of AMP value and reputation leading to more jobs being cut).

Several of the largest companies in the finance sector are good examples of the need for greater accountability in relation to corporate governance and specifically senior executive remuneration. We know first hand of the negative effects such excesses at the top of the corporate tree, particularly when it occurs within a context of cost cutting at the lower levels of the organisation.

We have witnessed the disregard adopted by the leaders of our industry for their employees, their customers and their community as a direct consequence of massive remuneration packages being based solely on shareholder return. The race to outbid one another, particularly in the banking sector during the mid to late nineties, on the amount of jobs they would shed and the amount of branches they would close to gain an immediate positive response from the 'market' was done without thought for the social impact of such decisions.

In fact, the finance sector is the exemplar of the corporate excess that is so detested by working people in this country. To support this assertion, a 2002 report found that overall, average weekly earnings in the finance sector were 74 times less than executive pay. For customer service staff, who earn considerably less than average weekly earning in the sector, the ratio was about 188:1 in 2002. The worst example of excess was the Commonwealth Bank of Australia where CEO David Murray earned 307 times the salary of a customer service representative. [1]

In response to the public outcry and political pressure from groups such as the FSU some banks have now admitted that they went too far in their cost reduction strategies. It is the FSU's contention that continued scrutiny of the impact of executive and directorial strategies on all stakeholders should be mandatory in relation to good corporate governance. This will benefit all those associated with our industry and stop the short-term madness of a single focus on costs.

The FSU believes that organisational decision-makers should have a greater regard for the interests of stakeholders such as employees, customers, and the broader community. Higher standards of corporate responsibility and accountability should be observed; however there is no simple way to achieve this.

Our submission will be divided into 6 broad sections.

1. Directors duties
2. Ratings services
3. Current reporting practices
4. AGMs
5. Works Councils
6. International codes

Directors duties

There does not appear to be a clear cut view as to whether the current regime under the Corporations Law permits directors to consider issues wider than the financial performance and future of the company itself.[2] FSU has previously advocated that the Corporation's Law should be amended to require directors of publicly listed companies to have a broader responsibility to stakeholders such as employees and customers;[3] however it is recognised that this may not be enough.

Regulatory requirements can establish some of the basic ground rules for corporate responsibility but they are not a sufficient condition to ensure a culture of corporate social responsibility. The FSU believes that a broad range of incentives, education and information will be required (along with legislative change) to address the short term focus on shareholder returns. In addition, any changes are likely to occur slowly over time as market behaviour develop and responds to community pressure and legislative guidance.

[1] Shields, O'Donnell & O'Brien, "The Buck Stops Here: Private Sector Executive Remuneration in Australia" A report prepared for the Labor Council of New South Wales, 2003 at page 37

[2] See Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005), and Peter Henley, 'Were Corporate Tsunami Donations Made Legally? '(2005) 30(4*) Alternative Law Journal.*

[3] Recommendation 5, Submission on Exposure Draft CLERP 9 (Audit Reform and Corporate Disclosure) Bill 2003

The FSU would advocate that section 181 of the Corporations Law be amended to proactively require directors to also have regard to the interests of people or organisations who the company may have or is likely to have a business or employment relationship, or who may be directly affected by the business of the company. At a minimum the law should be amended to clarify that directors ***can*** have regard to these stakeholders.[4]

Ratings services

The growing profile of various ratings agencies who provide assessments of companies' activities according to various ethical, environmental, labour, safety criteria are a strong sign that the market and society are increasingly interested in the 'non-financial' aspects of a company's behaviour.

FSU generally supports the concept of independent ratings agencies that provide these types of ratings and information, however it is critical that these agencies are truly independent and have transparent and fair process to ensure that any ratings are robust and reliable. Unfortunately the FSU has recently encountered one ratings agency that was not interested in receiving any union input into its public ratings for 'workplace practices' preferring to simply rely primarily on information in the public domain. This was particularly disappointing given the ACTU, FSU and other unions were actively involved in helping the agency to establish credibility in its early years of operation.

In a broad sense, many ratings agencies are assessing the levels of transparency and accountability displayed by companies; consequently it is reasonable to expect that these agencies will themselves display high levels of transparency and accountability.

Current reporting practices

FSU argues that it is time to require companies to set broader measures of performance than those based simply on shareholder return. This is not to undermine the importance of shareholder return as a measure of performance, but to ensure that executives consider the interests of all stakeholders in the company and the way that stakeholder satisfaction contributes to long term strength in company performance and growth. FSU argues there must be the capacity for greater control over executive and non-executive director remuneration and performance measures. Too often, stakeholders such as employees and customers have paid the price with their jobs or the loss of their local branch while executives increased their wealth by meeting performance hurdles based solely on shareholder value.

Financial measures alone are insufficient for modern organisations. FSU would argue for measures that include customer satisfaction, employee satisfaction and motivation, process improvement, corporate reputation and strategic development.

In response to documents such as the 'social charter' developed by FSU[5] we have begun to see individual companies in the sector move their language in recognition of the community's displeasure with their behaviour. From the ultra arrogance of the late 1990's when bank CEO's would brazenly tell the public that they had no community service obligations, we have seen the shift to language of responsibility, qualified

[4] As suggested by Henley (above).

[5] Available from www.fsunion.org.au

moratoriums on branch closures and recognition of the importance of stakeholders other than shareholders.

Many of the 'charters' and programs referred to in the annual reports of Australian finance companies are self determined, self evaluated and lacking the rigour of genuine consultation and involvement of stakeholders. The results derived are therefore not reflective of the daily realities and often deceitfully and cynically used for the purposes of seeking to improve market positioning.

FSU members would support any measures that provide any additional controls and/or scrutiny of executive and non-executive director remuneration. In general, the FSU supports reforms to the Corporations Act to the extent that they increase transparency and accountability in relation to remuneration of directors and management.

However, we argue that the time has come for the government to require companies to use broader measures of performance that incorporate the interest of stakeholders such as employees, not just shareholders.

There is undoubtedly a growing recognition that a good disclosure regime includes financial and non-financial information.[6] Numerous companies have started to adopt these types of practices in their annual reports and/or discrete reports such as sustainability, stakeholder or social impact reports. The FSU welcomes these initiatives; however they are still in their infancy and could be greatly improved by incorporating a much wider amount of information and by incorporating some of these non-financial indicators into performance agreements for senior executives.

The Global Reporting Initiative (GRI) provides a comprehensive framework for companies to report against various indicators of economic, environmental and social performance. A recent report commissioned by the CPA[7] provides a useful guide as to which GRI indicators are being reported by the top 100 Australian companies. Unfortunately, it shows that most companies are not reporting information that would satisfy many of the GRI criteria, in fact some companies do not appear to be reporting GRI type information even when they are legislatively obliged to do so[8].

It is encouraging that a few companies are reporting some of the GRI indicators **and** having the results verified and audited by third parties. Ideally all companies would report all indicators and have them audited but this may take many years to develop.

The FSU supports greater reporting by Australian companies using the GRI indicators. This could be encouraged and rewarded by the directors of companies and, ideally, by the market itself as it evolves and matures. Alternatively, they could be mandated by legislation.

[6] See *OECD Principles of Corporate Governance 2004.* Principle V – Disclosure and Transparency – specifically mentions that disclosure should include information regarding "key issues relevant to employees and other stakeholders that may materially affect the performance of the company." Also see ASX principles 5 and 6 from *Principles of Good Corporate Governance and Best Practice Recommendations 2003*.

[7] *Sustainability Reporting Practices, Performance and Potential A research project commissioned by CPA* Australia July 2005.

[8] CPA report – page 12 and appendix 2.

AGM actions & experiences

FSU is itself a shareholder and more importantly, has an increasing number of members who own shares in the companies for which they work. For the past few years we have been involved in the processes of shareholder participation currently facilitated by the Corporations Law, particularly in relation to section 249N members' resolutions and section 249P members' statements. These sections provide an important mechanism by which smaller shareholders can be active in their affairs of companies.

These actions have usually been taken to raise awareness of certain issues (usually related to industrial matters) and place pressure on board members. These actions have generally been accepted as a legitimate way of expressing stakeholder concern; however, the Commonwealth Bank (CBA) has been pursuing the FSU through the Federal Court regarding action taken by FSU at the 2004 AGM.

The FSU sought to raise concerns regarding the '*Which New Bank?*' change program that is being aggressively pursued by the CBA and consequently proposed an independent audit to be conducted to ensure that employees and customers were not being disadvantaged. The CBA is alleging that the FSU's action was in breach of the *Workplace Relations Act*. The CBA's actions may be indicative of a disturbing trend to use legal action in an effort to silence dissent regarding how companies are run (ie Gunns).

AGM's provide a key mechanism for shareholders and stakeholders to ask questions and provide feedback regarding the performance and running of the company. The FSU is both a shareholder and a stakeholder in relation to CBA – it would be a significant setback in stakeholder engagement if one of Australia's major companies succeeded in denying stakeholder groups access to basic accountability mechanisms such as AGMs.

Accountability mechanisms are useless unless they allow for dissent and criticism to be voiced and lessons to be learned.

Works Councils

Since the mid-90's the European Council has established arrangements for mandatory works councils and guidelines for informing and consulting employees. The works council directive was adopted in 1994[9] with the further directive on consultation and information issued in 2002[10]. Works Council agreements now cover over 700 companies or groups in the EU and approximately 11 million employees with roughly 10,000 employee representatives involved.[11]

These are described by Paul J Gollan and Glenn Patmore writing in the *Age*:

> The directive requires the establishment of elected committees of employees, called "works councils", which are consulted by management on key company decisions. Works councils are designed to improve workers' rights in the areas of information, consultation and participation. They are also designed to promote dialogue between management and labour, and to deal with the

[9] European Council Directive 94/45/EC.

[10] European Council Directive 2002/14/EC.

[11] EUROPA - portal site of the European Union - http://europa.eu.int/

> problems resulting from corporate restructuring and transnationalisation. This kind of dialogue has been sorely lacking in Australia of late, as evidenced by the fallout from spectacular corporate collapses.
>
> Another advance in the development of social partnership in Europe has been a brand-new directive on information and consultation in the workplace. This directive is aimed at improving the information and consultation rights of employees in small and medium-sized enterprises. Its primary focus is on companies operating within national borders. The directive seeks to enhance the employability of workers through the provision of information and consultation on pertinent workplace and company matters. The presence of a social partnership philosophy is evident in the objectives of the directive, which seek to promote social trust and to extend economic benefits to all citizens.
>
> Unlike the European Works Council Directive, it does not mandate the establishment of a works council, but leaves open the kinds of arrangements that might be implemented. However, some measure must be adopted, such as biannual employer-employee meetings to discuss the present state and future direction of the company." [12]

The FSU would welcome a discussion around the possibility of introducing similar arrangements in the Australian context as a way of increasing consideration of stakeholder interests and promoting dialogue.

International codes

The FSU supports Australia being internationally competitive and adopting world's best practice. The FSU is cognisant that there are numerous international codes of practice that may assist in this regard by raising the standards of corporate behaviour. Some of the main international codes include:

- ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy;
- OECD guidelines for Multinational Enterprises;
- UN Norms in the Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights.

The FSU notes and endorses the appraisal of these codes contained in submissions to this inquiry by the ACTU and the PILCH Homeless Persons' Legal Clinical.

In the time available the FSU has not formed a definitive view on these codes but believes the UN Norms provide a comprehensive and holistic code of practice for businesses of all types. The FSU endorses the provisions around the Rights of Workers (s5-7) and the wide definition of stakeholder (s22). Adoption of the UN Norms into Australia's regulatory structures as described in s17 would assist with raising standards of corporate social responsibility.

[12] "*Our ailing industrial relations needs some European tonic*" Paul J Gollan and Glenn Patmore, **The Age**, 30.12. 2002

If you have any questions in relation to this submission please contact Rod Masson (03) 9261 5330 or James Bennett (03) 9261 5321.

Yours sincerely

Paul Schroder
National Secretary
15 September 2005

MACQUARIE
UNIVERSITY ~ SYDNEY

24 February 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Parliament House
Canberra ACT 2600

Dear Mr Kluver,

Thank you for the opportunity to make a submission to the Corporations and Markets Advisory Commission inquiry into corporate social responsibility. Given the similarity in the CAMAC terms of reference to the Parliamentary Joint Committee on Corporations and Financial Services, I have attached my submission to the PJCCFS inquiry for your consideration. I have also included a relevant paper (co-authored with Dr. Ken Cussen) which was published in the journal *Essays in Philosophy* as part of a special edition on corporate social responsibility in June 2005.

I would also like to take this opportunity to emphasise a point which often seems to be overlooked. It is obvious that corporations operating to generate financial returns may create significant social and environmental disutilities. But it is this very pursuit of profit within legal constraints which distinguishes a corporation from a government entity or NGO. This raises two key questions. First, how can corporate profitability be aligned with wider social and environmental objectives? The typical answer is to utilise taxes and subsidies together with prescribing minimum standards of stakeholder obligations. Such mechanisms are not always successful, however, particularly with respect to operations in the developing world. This leads to a second question: when profit maximising behaviour would result in adverse societal outcomes how can corporations be encouraged to sacrifice such profits?

The proposed changes to broaden the fiduciary responsibilities of directors are an attempt to address this second question. Such an attempt rests on an implicit assumption that these fiduciary responsibilities drive corporate profit maximising behaviour. But as Milton Friedman observed over thirty years ago, it is competitive markets (for capital, labour, customers and so on) that are a much more powerful force. Friedman argued that even if managers wanted to act in a socially responsible way (which he opposed on moral grounds), their companies would become less profitable and ultimately vulnerable to hostile takeover. If Friedman is right, and I think his thesis is largely persuasive, this severely limits the possible impact on corporate behaviour from legislative change to directors duties (or from corporate reporting). It may be, therefore, that we need to look at non-corporate organisational structures to deliver goods and services where there is a significant potential for adverse social and environmental consequences. In short, we must acknowledge that the square peg of the corporate form will never easily fit into the round hole of social and environmental responsibility.

Yours sincerely

James Hazelton
Lecturer
Department of Accounting and Finance

Submission to Senate Inquiry into Corporate Responsibility

James Hazelton

September 2005

Corporate Social Responsibility

The starting point for most discussions of Corporate Social Responsibility (CSR) is the work of Milton Friedman (Friedman 1982, Friedman 1970/1993) who believed businesses should maximise profits within the existing legislative framework. Friedman presented both ethical (normative) and commercial (positive) reasons to support his position. He believed it was unethical for managers to deviate from profit maximisation because they:

- Are agents of shareholders and the objective of shareholders is to maximise their financial returns;
- Lack the ability to make social decisions; and
- Are not democratically elected.

Friedman's ethical arguments have been challenged by numerous authors on both Kantian and utilitarian grounds. Very briefly, Kantian ethics suggests people have inalienable rights and should never be treated solely as a means to an end, but always as an end in themselves. Kantian ethicists therefore reject Friedman's approach, as they believe it violates the rights of the other stakeholders of the firm (Freeman 1994, Freeman and Reed 1983). By contrast utilitarian ethics seeks to maximise the utility (or happiness) for the greatest number of people. Using this approach, Boatright (1994) challenges Friedman's claims on the basis that maximising returns for shareholders may not with maximise utility for society at large. Using these arguments (and others discussed in Hazelton and Cussen (2005)), Friedman's normative position is generally rejected.

A more simplistic version of Friedman's normative account is the common modern claim that 'good ethics is good business'. According to this view, the interests of corporations and the interests of the community as a whole are closely aligned, which neatly solves any ethical questions and makes significant regulatory intervention redundant. While strong ethics may translate into profits in some cases, the existence of obvious counter-examples (tobacco companies, highly polluting factories and mines, companies utilising sweatshop labour and so on) make the principle highly suspect. A common response to these counter-examples is that this alignment takes place over the 'long run.' However, as Keynes famously observed, in the long run we are all dead! More seriously, while it might be true that society eventually acts to price externalities and therefore align profitability with societal benefits, it is also clear that significant social and/or environmental harm can result in the interim.

Therefore in respect of part (b) of the Terms of Reference I suggest there is a very strong case for believing that corporations should have regard for stakeholders other than shareholders above and beyond the minimum legal requirements.

The key question is therefore whether corporations *will* have regard for such other stakeholders. Friedman claimed that they will not. He argued that even if managers wanted to they could not deviate from a profit maximising position because of competitive markets:

> And, whether he wants to or not, can he [the manager] get away with spending his stockholders', customers' or employees' money? Will not

> the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibility (1970/1993 p. 251-252).

This competitive markets argument (particularly when combined with the existing imperatives of the Corporations Law for directors to act in the interests of shareholders) suggests that it is unlikely that corporations will deviate from profit maximisation in any significant way.

Therefore in response to part (a) of the Terms of Reference, I suggest that corporate decision-makers do not have regard for stakeholders other than shareholders where this conflicts with profit maximisation.

In conclusion, from an ethical perspective citizens would like to see corporations having regard to stakeholders other than shareholders. However due to commercial pressures and legal requirements this is will not occur when such regard would result in lower profits for the corporation.

What can be done? While it may be desirable to impose a blanket principle requiring directors to balance the interests of shareholders with other stakeholders, it is difficult to see how this could be achieved in practice, particularly given the commercial pressures noted above. However, the Committee could consider adopting the United Nations Norms on the Responsibilities of Transnational Corporations in order to prescribe minimum standards on Australian companies operating abroad.[1] A possible objection is that this may harm the competitiveness of Australian companies. However, if we are to believe the rhetoric, most companies already seek to maintain ethical standards to preserve their reputation and therefore compliance costs will be minimal. Even where these costs are material, surely the benefits of protecting basic environmental and human rights comprehensively outweigh them.

While general principles are important, the main mechanism for the protection of stakeholders has been and will continue to be specific provisions enacted by the various levels of government. The community relies on the democratic process to ensure their views on acceptable corporate behaviour are translated into law. Naturally, the corporate sector is entitled to participate in the dialogue, however given their substantial access to resources it is vital to ensure their influence does not overwhelm that of private citizens. An area of particular concern is the ability of either corporations or corporate leaders in their capacity as individuals to make political donations. Such donations invite the perception of corporations being able to 'buy' favours, whether or not this is the case. As Leigh (2004) explains:

> Politicians routinely deny that money influences the way they vote; money buys access, not outcomes. Yet as Kim Beazley admitted: "It is

[1] A similar approach was adopted in the US through the creation of the Foreign Corrupt Practices Act 1974 which holds US firms to certain standards of ethical conduct regardless of where they operate.

> simply naïve to believe that no big donor is ever likely to want his cut some time".

Donations by highly regulated industries such as information technology have risen substantially (Crowe 2005). Critics such as Tham (2004) point to increased corporate funding predominantly drawn from large corporations. Tham suggests such funding undermines the Australian democratic system in two important ways. First it contributes to financial inequalities between parties – for example, the National Party received more than nine times more funding per vote than the Democrats or the Greens. Second it may result in the policies of the major parties being skewed towards the interests of the large corporate donors.[2]

Given these issues, organisations such as the Australian Shareholders Association have called for a ban on corporate political donations (Percy 2004). I endorse this position and encourage an outright prohibition on political donations including corporate donations. Not only would this improve both the practice and perception of the legislative process it would also free politicians from the necessity of spruiking for campaign contributions and enable them to focus on more important work.

Governments also play a key role in aligning the interests of the community with that of the corporate sector through intervening in the market by imposing taxes and granting subsidies. The renewable energy sector is a good example in which there are mandatory renewable energy purchases for power companies and subsidies for private solar power installation. However there are also numerous instances where taxes and subsidies are inconsistent with broader social and/or environmental objectives such as the fringe benefits tax regime encouraging higher levels of car usage and the purchase of newer cars (for a comprehensive study see Van Dyke (1999)). I suggest a bipartisan review of the current incentive structures to identify and address those that are 'perverse'.

Finally, while I acknowledge this is outside the scope of the present inquiry, I also encourage the Committee to reflect on the question of whether the corporation is always the ideal organisational form to provide goods and services to the community. While there is a strong trend towards privatisation of government organisations, when externalities are significant and outcomes difficult to specify the corporate form may well deliver sub-optimal outcomes. Activities such as management of detention centres and essential utilities may result in negative social and/or environmental outcomes when left to profit maximising operators.

[2] This problem is not confined to Australia - in a survey of 104 countries, Pinto-Duschinsky (2002) found only 16% had either partial or complete bans on political donations. In the UK, the Blair government campaigned on the issue of reforming the political donation process in 1997, but subsequently faced a number of allegations of favouring large donors such as Bernie Ecclestone and Enron. They are currently under attack over the proposal to allow companies to donate to Trade Unions without obtaining the usual shareholder approvals required for any political donations. It is alleged that the unions will simply pass the funds on to Labour, who received 66 million pounds of donations in the last governmental period (Kite 2005). In the US, concerns about the role of political donations led to the creation in 1997 of Democracy 21, a non-profit organisation which focuses specifically on this issue. Donations for the 2004 US elections totalled well over $US750 million (Justice 2004).

Reporting

In respect of part (f) of the Terms of Reference, the question of the most appropriate reporting for corporations regarding CSR issues has been debated for many years. Authors such as Hines (1988) suggest that what gets reported is critical for our perceptions of whether an organisation is 'successful' and therefore whether or not its licence to operate is revoked (though Gibson (1996) provides an alternate view). As social and environmental reporting is almost completely unregulated, it currently provides an opportunity for companies to manage reputational risk rather than meet the information needs of users. Academic research has found a *negative* correlation between reporting and performance (Deegan and Rankin 1997)[3]. This finding has been explained using 'legitimacy theory' which essentially suggests that corporations undertake more extensive reporting when they believe that their legitimacy is threatened (Deegan 2002). The lack of regulation can also result in misleading reporting. During the recent NSW Parliamentary Inquiry into sustainability reporting by NSW government agencies, the CEO of Integral Energy admitted under examination that the organisation had reported their positive environmental initiatives (such as using recycled paper) in the annual report but had not mentioned the negative environmental impacts from sourcing the overwhelming majority of power from coal-fired generators (NSW Public Accounts Committee 2005 p28-29).

However, there are at least three categories of the community which would find regulated, standardised corporate reporting useful. First, such information may be material to profit maximising investors. As social and environmental externalities are identified, they are eventually placed onto the firm (the tobacco industry being a good example). Therefore, an investor who better understands the environmental and social impact of a corporation has an understanding of the extent to which the future operations of the company may be affected by more stringent regulation and is able to better price the security. Second, some investors consider themselves citizens as well as economic agents and therefore wish to evaluate an organisation's social and environmental performance quite apart from any economic effects. Finally, citizens who are not direct investors may also be impacted by the firm through their position as an employee, customer, supplier etc. and/or be concerned about a particular social or environmental issue. Given the increasing influence of corporations, a strong argument can be made to require corporations to report on the impact of their activities.

Even if it is agreed that corporations should report on their activities, a key question is what they should report. There are numerous examples of sustainability reporting and suggested standards. However, as the Committee is no doubt aware, the Global Reporting Initiative (GRI) is the leading standard setting body and I see no reason why the reporting in accordance with GRI standards (or even a sub-set of the standards) could not be made mandatory. Corporations could, of course, continue to report additional

[3] A prime example is British American Tobacco which won a UK Sustainability reporting award in 2002.

information as desired. The GRI has been recommended as the starting point for sustainability reporting by the Group of 100 (2003), though it has been disappointing to note their continual resistance to any form of mandatory social and environmental reporting.

Again a likely objection is that this will place an additional cost on corporations. While this may be the case I would argue that this cost will be outweighed by the benefits to investors and the community at large. Indeed, the prevalence of reporting in the absence of regulation demonstrates that corporations themselves believe that such reporting is important, albeit largely as a marketing tool.

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The Amorality of Public Corporations

James Hazelton and Ken Cussen

Abstract

We consider whether public corporations can be ethical, using the notion of corporate social responsibility (CSR). We distinguish between 'weak' CSR (where corporate profitability is enhanced by pursuing social and environmental objectives) and 'strong' CSR (where it is not) and consider four possible positions in relation to strong CSR. First, CSR is unnecessary – good ethics is synonymous with good business. Second, CSR is unethical as the government is responsible for intervention in markets. Third, CSR is ethical and is being implemented by corporations. We find none of these positions convincing and argue a fourth position – CSR is ethical but impossible for corporations to implement due to competitive markets and the legal requirements of the corporate form. We conclude that public corporations are best considered amoral entities. In order to alleviate the inevitable negative social and environmental outcomes arising from corporate activities we suggest strengthening the regulatory environment and using alternate organizational forms to conduct economic activities.

Introduction

The creation of the corporate form is unquestionably one of the most important inventions of humanity. Almost everything we wear is produced by a corporation (often thousands of miles away) and if we look around our home, almost every item, from the television to the lounge to the cutlery on the table has been created by the corporate system. Since the industrial revolution, the corporation has transformed the material standard of living for millions, if not billions. On this point, even Adam Smith and Karl Marx agreed. Given this success, it is not surprising that the modern corporation has unprecedented wealth and power. A recent study comparing the market value of companies to countries (measured by stock market capitalisation) found that 24 out of the largest 50 economic entities in the world are corporations (Sheehan 2005).

Corporations are not a completely benign force, however. Again both Smith and Marx were in agreement that there were negative side effects to the capitalist economy, and they particularly focused on its impact on the worker. As Smith believed education occurred primarily in the workplace, he understood increasing specialization would breed ignorance:

> In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is, of the great body of the people, comes to be confined to a few very simple operations; frequently to one or two. But the understandings of the greater part of men are necessarily formed by their ordinary employments. The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion,

> and generally becomes as stupid and ignorant as it is possible for a human creature to become (1776/1998 p429).

Marx was even more scathing in his critique. Believing meaningful work is fundamental to full realization of humanity, he contended that such specialization, combined with the division of labor between the worker and the capitalist, alienated the worker from their work and ultimately from themselves. Marx states that:

> The more wealth the worker produces, the more his production increases in power and scope, the poorer he becomes. The more commodities the worker produces, the cheaper a commodity he becomes. The extinction of value from the world of things is directly proportional to the devaluation of the world of men. Labour does not only produce commodities; it produces itself and the worker as a commodity (1844/1983 p133)

The ultimate result is profound alienation - as the highest function of humanity (i.e. work) is stripped of meaning, the worker is no longer fully human (1844/1983 p137).

While the debate around employee rights continues (especially in the developing world), more recently the critique of corporatism has widened to consider other stakeholders such as customers, the wider community and the environment. In respect of customers issues range from product safety and truth in advertising to allegations of bias in media companies such as Fox. Corporations have been accused of ignoring the impact they have on communities when they close factories or mine on indigenous land. The environmental performance of corporations has also come under fire, particularly in respect of pollution and resource consumption.

In the field of business ethics, such issues are typically dealt with in isolation. The pros and cons of a particular course of action can be debated and analysed. A particular corporation can be praised or condemned for their actions. However, the deeper structural issues within the world of business, particularly in respect of large public corporations, are rarely considered in depth. This is the focus of our paper.

One way of considering such structural issues is by using the notion of corporate social responsibility (CSR). Corporate social responsibility has been defined as an corporation's perceived societal obligations, the response to which generates corporate activities, reporting and status (Gray, Kouhy, and Lavers 1995; Hooghiemstra 2000). It is helpful to further refine this definition and distinguish between 'strong' and 'weak' CSR (this distinction is sometimes referred to as ‘broad’ versus ‘narrow’ conceptions of business ethics – see for example Shaw and Barry (2004 p212-214)).

‘Weak’ CSR is where businesses engage in socially or environmentally positive behavior but where the motivation is profit maximization. This type of CSR is typically a response to attacks on the legitimacy of corporations. As Friedman (1970/1993 p253) puts it:

> In practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for such actions . . . in the present climate of opinion, with its widespread aversion to ‘capitalism’, ‘profits’, the ‘soulless corporation’ and so on, it [social responsibility] is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest.

Strong CSR, on the other hand, entails a corporation acting contrary to its economic interests to pursue some other social and/or environmental objective. It means pursuing some environmental or social objective which involves a cost which will *not* be recovered either directly or indirectly through enhancement to reputation, increased customer loyalty and so on.

Since corporations seek to maximize profits, we can safely assume that they will (eventually) adopt all opportunities for weak CSR. There are widespread examples of weak CSR in action, from charitable donations to companies increasing social disclosures in their annual reports in order to legitimize their activities (Hooghiemstra 2000). Therefore, this form of CSR need not concern us, and all further CSR references are to strong CSR.

We consider a number of possible positions in relation to CSR. The first view is CSR is unnecessary – good ethics is synonymous with good business. Smith's 'invisible hand' means self-interested acts result in the collective good. The second view is that while collective good does not necessarily result from free markets, any correction should be provided by government, not business. Indeed CSR is immoral – any monies managers spend on non-profit maximizing activities are stolen from shareholders. The third view is CSR is moral – corporations do have a responsibility to go beyond financial self-interest - and is actually happening. We find none of these positions convincing and argue for a fourth view – though CSR may be desirable, it is impossible for public corporations to implement due to competitive markets and the legal requirements of the corporate form.

CSR is unnecessary

For some commentators the entire CSR debate is redundant as 'good ethics is good business'. For example, the following quote is from a typical finance text: 'In most instances there is little conflict between doing well (maximizing value) and doing good. Profitable firms are those with satisfied customers and loyal employees; firms with dissatisfied customers and a disgruntled workforce are more likely to have declining profits and a lower share price' (Brealey and Myers 2000 p. 27). Many companies (unsurprisingly) support this view, and Shell has made it central to their public relations campaign with the slogan 'profits and principles – does there have to be a choice?' Indeed, Shamir (2004 p676) argues the entire notion of CSR has been framed in this way.

Some commentators go as far as believing that being 'good' can become a competitive advantage. A typical example is Devero (2004) who in her piece *Corporate Values Aren't Just Wall Posters – They're Strategic Tools* discusses how corporations 'can use value-based strategies as tools, not just to avoid scandals and litigation, but also to achieve competitive advantage and higher profits' (p19). (Empirical evidence as to the success of this 'strategy' is mixed – see Hartman (2005 p270-272)).

The root of the argument can be traced to Smith's famous 'invisible hand' theory, where individuals acting out of collective self-interest create the public good:

> . . . every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor

> knows how much he is promoting it . . . he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was in no part his intention' (Smith 1776/1998 p291-292).

When applied to corporations, this means that profit maximization creates the public good. As a recent edition of The Economist focusing on CSR explains:

> Smith was a genius because this harmony of private interest and public interest is not at all obvious – and yet, at the same time, once it is pointed out, the idea is instantly simple and plausible. This is especially so if you think not about self-interested individuals but about profit seeking companies. The value that people attach to the goods and services they buy from companies is shown by what they are willing to pay for them. The costs of producing those goods and services are a measure of what society has to surrender to consume those things. If what people pay exceeds the cost, society has gained – and the company has turned a profit. The bigger the gain for society, the bigger the profit. So profits are a guide (by no means a perfect one, but a guide nonetheless) to the value that companies create for society (The Economist 2005b p15).

Historically, perhaps the most important response to the 'invisible hand' was Garrett Hardin's famous *The Tragedy of the Commons* (1968). Hardin takes Whitehead's definition of tragedy being the 'remorseless working of things' and using the example of sheep herders shows how self-interested actions eventually result in the destruction of commons. If the carrying capacity of a common is say, five sheep, it is still in the interests of each herder to graze additional sheep as the incremental benefit of the herder's extra sheep is realized by the particular herder alone while the incremental cost is shared by all the herders. The commons are inevitably over-grazed and eventually destroyed. Therefore, individuals acting solely from self-interest reduce, rather than promote, the well-being of society.

The more modern conceptualization of this phenomenon is under the banner of 'externalities'. The problem is that profit does not capture the 'true' costs and benefits of transactions, only the price which is paid for them in the marketplace. (For an interesting discussion of the subjective nature of accounting profits see Hines (1988)). A factory polluting the atmosphere is using a public common but not bearing the eventual costs of acid rain or global warming. The profits of such a firm are therefore overstated. Likewise, a tobacco company may not pay the full costs of the harm that its products cause. Externalities can also be positive, such as where education results in not just a higher income for an individual but also for the country through the individual paying greater taxes. The result of mispricing such externalities is that more under-priced (and less over-priced) resources are used than would be optimal for society.

Moving beyond individual businesses, although there are some industries with little conflict between 'profits and principles' (such as waste management, alternative energy or education), in others the distinction is problematic (such as armaments, pornography, logging, gambling, alcohol, tobacco and mining). Clearly, then, wholly free markets do not produce optimal outcomes for society.

There are two possible responses to this conclusion. One is that businesses must take responsibility for addressing this problem. The other (and much more usual) response is that market intervention is the responsibility of governments – and this neatly solves any qualms a corporation may have pursing profit maximization. This position is considered below.

CSR is immoral

The idea that business has no moral obligations beyond profit maximization can be traced back at least as far as Levitt (1958) and Carr (1968). Levitt considered that placing responsibility for social welfare on corporations was dangerous because it allowed the influence of corporate operations to extend into all spheres of society. Carr believed corporations have no social responsibility because business is a 'game' and so any action is moral as long as it is lawful.

Friedman (1970/1993; 1982) extended these arguments with additional sophistication. He presents three main arguments to support his position:

- Managers are agents of shareholders – as managers are not owners, they do not have the right to impose their beliefs on the owners of the firm. If owners want to support a particular cause then that is their right. However, for a large company with many shareholders there is unlikely to be consensus. Therefore, managers should distribute as much money as possible to shareholders and the shareholders can then individually support their chosen cause. A manager using company funds for a non-profitable cause is thieving from owners.
- Corporations do not have the skills to make ethical evaluations. Corporations are designed for profit and their employees are trained to create wealth. They are not equipped to deal with public policy decisions which would include social and environmental considerations.
- Corporations are not democratically elected. Therefore, they do not necessarily represent the 'will of the people'. Thus even if a corporation had the skills to make public policy decisions it would be inappropriate for them to do so.

Central to Friedman's position is the role of the state as the conduit for society's wishes. The state sets the rules of the game in which business operates. Therefore if utilitarians or Rawlsians (or even libertarians) believe the outcome or conduct of the 'game' is unjust, they can intervene by changing the rules through the democratic process.

This is a very common view in today's corporate landscape. For example, the Australian Shareholder's Association advocated exactly this position in relation to corporate donations in respect of the 2004 Tsunami disaster, suggesting corporations should not make a donation unless there was a clear business case for doing so (Australian Broadcasting Corporation 2005). The Economist piece cited earlier concludes:

> As a general rule, however, correcting market failures is best left to government. Businesses cannot be trusted to get it right, partly because they lack the wherewithal to frame intelligent policy in these areas. Aside from the implausibility of expecting the uncoordinated actions of private firms to yield a coherent optimising policy on global warming, say, [note the rejection of the invisible hand argument here] there is also what you might call the constitutional issue. The right policy on global warming is not clear-cut even at the global level, to say nothing of the national level or the level of the

> individual firm or consumer. Devising such a policy, and sharing the costs equitably, is a political challenge of the first order. Settling such questions exceeds both the competence and the proper remit of private enterprise (The Economist 2005b a p18).

However there is a serious problem with the argument that ethical business consists of profit maximization subject to legal compliance. The argument rests on the assumption that the legislative environment directs business activity toward ethical outcomes, or at least represents the ‘will of the people’. There are, however, a number of circumstances where this is not so. First, there will always be a time lag in drafting and passing new legislation. Second, it is almost impossible to draft foolproof legislation. Inevitably there will be some loophole that can be exploited which complies with the ‘letter’ of the law but not its ‘spirit’. Third, the Friedman world ignores the influence that corporations have on regulation.

The Ford Pinto case illustrates these problems were significant even in Friedman’s day. Dowie (2004) explains that the then Ford CEO, Lee Iacocca, believed ‘safety doesn’t sell’ and had set strict limits on the cost, weight and development time of the Pinto. Due to the design and placement of the gas tank, rear-impact collisions were likely to rupture the fuel tank and explode. Ford knew this – Ford had crash tested the Pinto at a top-secret site more than 40 times and every test made at over 25mph without special structural alteration of the car resulted in a ruptured fuel tank. In 1968 the federal regulator (the National Highway Traffic Safety Administration (NHTSA)) proposed Standard 301. This Standard required cars to withstand an impact of 20mph without losing fuel. Ford used a variety of tactics to delay its introduction. Ford first claimed fire was not a significant issue for automobile safety. In response the NHTSA conducted a number of studies which conclusively refuted this claim. Next, Ford conceded that while fire may be a problem, rear-end collisions were relatively rare and therefore should be excluded from the standard. The NHTSA again conducted research which found that rear-end collisions were seven and a half times more likely to result in fuel spills than front-end collisions. Ford then argued that while fire might be present in accidents, it was not the fire but rather the impact that killed car occupants. When this argument was also rejected, Ford claimed that implementing the changes required under the Standard would take 43 months (which was somewhat surprising given the 24 month development period for the entire car). Finally, in 1977, almost ten years after the legislation was first proposed, Standard 301 was enacted. The new Ford Pinto complied with the Standard with the addition of a one-dollar part.

This case shows the difficulties facing a government, even in the developed world, to implementing legislation that curtails corporations. Ford successfully delayed Standard 301 but in so doing caused unnecessary serious injuries and deaths. The Friedman view ignores the huge influence that corporations have on regulation. Corporations have well organised lobby groups, and the resources to donate directly to political parties and attend political fundraisers. Business therefore has a better opportunity to argue its case to politicians than other community sectors.

Even Smith believed businessmen were not only likely to influence regulation, but also unlikely to promote the public interest. He stated that merchants and manufacturers have frequently claimed that what is good for them is good for the public, though the opposite is often the case:

> This interest of the dealers, however, in any particular branch of trade of manufactures, is always in some respects different from, and even opposite to, that of the public . . . The

> proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it . . . (1776/1998 p157)

In the modern era, this influence is demonstrated by the creation of taxes and subsidies that serve corporations at the expense of the public. In an extensive review of such government policy in Australia, Van Dyke (1999 pi) found over $14 billion in industry 'assistance' was paid by the three tiers of government in the year 1998-99 and:

> whilst this expenditure is an obvious boon for recipient companies, negative effects stem from such transactions and are felt both at societal and even more intensely at environmental levels . . . the practice of offering sectors such as primary production and mining continual assistance is particularly ironic considering the taxpayer pays twice; once by way of a subsidy to encourage an activity eg cropping, extensive cattle grazing and ore extraction and then again in environmental expenditure to clean up the degradation caused by that activity eg salinity, soil erosion and loss of biodiversity. Thus the Commonwealth government (not including extensive state support) on one hand extended $1,058 million to primary production and mining in 1998-99 and at the same time spent $5,200 million (estimated from 1996-97 figures) cleaning up the mess.

The situation is similar in the US. Shaw and Barry (2004 p161-162) point out that 'Every year the federal government doles out an estimated $85 billion to private business in direct subsidy programs . . . Some put total federal spending for corporate welfare at over $167 billion a year, which is far more than combined state and federal spending on social welfare programs for the poor.'

Further, some activities do not easily lend themselves to the free-market system. An example is the case of Australian Correctional Management (ACM), a for-profit company responsible for the management and operation of the Woomera refugee detention center. It was in ACM's financial interest to have disturbances (such as riots) at the detention center, as long as there were no deaths. This was because there were financial penalties for deaths, but the company was authorized to send additional staff in the case of disturbances for which they received above-award rates substantially in excess of what they had to pay the staff (Whitmont 2003).

Such problems are exacerbated in developing countries, which do not have the resources to create the voluminous legislation in western countries. In particular, labor laws in terms of pay, conditions and safety are often weak. Apart from the drafting, in order to be effective legislation must be enforced. This is difficult enough in a developed country, but in developing countries the situation is much worse. What laws exist are unlikely to be fully enforced due to resource constraints, difficulties in accessing geographically isolated areas and corruption. A well-known example is Nike. It has been alleged that workers in Nike factories in Vietnam receive only one toilet break, two glasses of water and $US1.60 for an eight-hour shift. The benefits to Nike are clear - all-up labor costs of less then $2 for items that retail for $149 (Grace and Cohen 2001 p191). Similar claims have been made against many other public corporations such as Wal-Mart, Gap, Mattel and Disney.

Governments in developing countries may be even more prone to corporate influence. A classic example concerns Resistol, a glue H B Fuller sells in South America where it is primarily used for making shoes. However the glue has also been widely used as a hallucinogenic by street children, causing significant and irreversible brain damage. In Honduras, legislation was proposed to require the company to add mustard to the glue and make sniffing impossible. However as Hayskar (1994) reported 'When the Honduran Congress debated the oil of mustard bill in 1988, H. B. Fuller weighed in with abundant corporate charm and a plethora of seemingly well-documented studies. Overwhelmed by H. B. Fuller's lobbying, in 1989 the Congress passed a watered-down law creating a commission that would set the amount of oil of mustard necessary. After more pressure and "scientific studies" from H. B. Fuller, the commission recommended zero percent.'

Finally, an obvious problem arises in countries when there is no democratic process in place, as laws in such countries can hardly be considered to represent the will of the people. The case of Shell in Nigeria, discussed by Grace and Cohen (2001 p194-195), provides an poignant example. Shell acted in accordance with the laws of the Nigerian military dictatorship in extracting oil and building a pipeline through the land of the indigenous Ogoni people. Not only did the Ogonis receive none of the wealth the oil provided, it polluted their land and created dangerous conditions for habitation. Far from being able to influence the political process, the leader of the Ogoni protests (Ken Sari Wewa) was executed by the dictatorship. Brooks (1995) gives a graphic account of the plight of the Ogoni people:

> Since Shell struck oil there in 1958 an estimated $US30 billion . . . has been extracted and sold. Yet the poverty of the 50,000 Ogoni remained desperate, even by the harsh yardstick of the poor world. As subsistence farmers dug for yams with sticks, their naked children drank from streams polluted by the toxic chemicals of neglected oil spills. Oil pipelines snaked hard up against the farmers' mud brick huts, even though current industry practice is to site them far from human habitation. I spoke to a woman burned in one of the inevitable oil fires that had resulted from this perilous practice. Still in pain almost three months later, she lay on the earthen floor of a traditional healer's hut, her burns wrapped in poultices of leaves. When I asked a Shell spokesman about her, he said the company was 'hazy' on the details of the accident, and couldn't investigate because of tensions in the area.

The position that corporations are ethical if they merely act within the established legal framework is therefore flawed. Sorrell and Hendry (1994) provide an explicitly philosophical consideration of this position using the standard ethical frameworks of Kantian, utilitarian, Aristotelian and Hobbesian morality. They have difficulties in finding self-interested business practice moral. The problem with Kantian morality is that it demands acts are done out of duty, rather than self-interest, which is hardly endemic in the business world. As Sorrell and Hendry put it:

> Are there any measures that a firm could implement in relation to society or the environment that are genuinely in keeping with Kantian morality? And could these activities be undertaken not only in theory but in practice, by a firm with real scale and

> profitability? Although the question needs more space than can be devoted to it here, it seems that the areas in which broad business ethics could prove their Kantianism would be those in which a society was seen as valuable not just because it was the source of consumption and labour but because it had a value in itself. To bring this down to earth, one could imagine a society being valued because of a particular way of life or valuable institutions or customs. Examples of this sort of society do not seem to be very numerous in business . . . (p39).

Likewise, using a utilitarian framework, business fails to act ethically on the grounds that it ranks outcomes in relation to the few (in particular shareholders, but also customers, employees and managers) over the many (such as society as a whole). For example, no business would voluntarily pay more tax than required even though the additional taxation monies might substantially benefit the wider community. Applying Aristotelian or 'virtue' theory meets with similar problems. For an act to be virtuous it has to be of good character, such as courage, temperance, justice and so on. For business, however, actions out of self interest would fail the virtue test, leading Sorrell and Hendry to conclude '. . we have not found in virtue theory a way of representing those actions as moral and self-interested at the same time' (p46-47).

It is the Hobbesian framework of ethical egoism that seems to fit business best – the problem is this demands little, if anything, that might be considered 'moral'. As Sorrell and Hendry point out:

> Ethical egoism has a certain naturalness as a framework for justifying corporate social responsibility and is the framework that seems to be implicit in the thinking of real firms engaged in real ventures in social responsibility. It is also perhaps the natural moral counterpart to the prevailing political philosophy of free-market capitalism, in which the economic pursuit of self-interest by competing businesses is supposed to be for the benefit of all. But even with the addition of the social contract, ethical egoism as generally interpreted is not very convincing as a general moral framework . . . certain acts that call for a great deal of self-sacrifice, and that might therefore ordinarily be regarded as close to ideal morally, should not be done at all. It is even possible to interpret ethical egoism to be saying that it is morally wrong to perform acts that are heroic or saintly (p48-49).

After considering these options, Sorrell and Hendry conclude 'it is hard to find a convincing moral theory that both allows self-interested acts to have moral value and does not demand acts that go beyond self-interest' (p49). A critical question therefore is whether corporations actually act in this way. Do corporations sacrifice self-interest in order to serve society as a whole? The following section considers the position of those that believe they do.

CSR exists

The overwhelming conclusion from the above analyses is that legal compliance is not enough *from society's perspective*. If we set profit maximization as the sole criteria for corporate performance, a number of unsatisfactory social and environmental outcomes will inevitably result. This position is relatively uncontroversial, and Friedman's normative claim is widely rejected. It is therefore concluded that corporations should 'do more' to address such issues.

Some writers believe the role of business has indeed changed. For example, Solomon (1991) believes 'profits are no longer condemned along with "avarice" in moralising sermons, and corporations are no longer envisioned as faceless, soulless, amoral monoliths' (p356). Solomon contends business is not just about making profits:

> 'Profits are a means to building the business and rewarding employees, executives and investors. For some people, profits may be a means of 'keeping score', but even in those cases, it is the status and satisfaction of 'winning' that is the goal, not profits as such . . . pursuit of profits is not the ultimate, much less the only goal of business. It is rather one of many goals and then by way of a means and not an end-in-itself' (p357).

Solomon concludes that the idea of corporate social responsibility is that the corporation should serve all stakeholders, not just stockholders: 'social responsibility, so considered, is not an additional burden on the corporation but part and parcel of its essential concerns, to serve the needs and be fair to not only its investors/owners but those who work for, buy from, sell to, live near or are otherwise affected by the activities that are demanded and rewarded by the free market system . . . the purpose of the corporation, after all, is to serve the public' (p. 361).

This 'public' might be further refined as comprising the stakeholders of the corporation. Among the most influential writers promoting the stakeholder view are Evan and Freeman (1988/1993). They propose a 'stakeholder theory of the firm' which asserts (adopting a Kantian approach) that all stakeholders have rights. 'Stakeholders' can be interpreted from both a narrow and wide stakeholder view – narrow stakeholders are groups vital to the survival and success of the corporation while wide stakeholders are any group or individual who can affect or is affected by the corporation (Freeman and Reed 1983). Stakeholder theory provides a radically different perspective of the purpose of a corporation:

> [it is] to serve as a vehicle for coordinating stakeholder interests. It is through the firm that each stakeholder group makes itself better off through voluntary exchanges. The corporation serves at the pleasure of its stakeholders, and none may be used as a means to the ends of another without full rights of participation in that decision (Evan and Freeman 1988/1993 p262).

Under the stakeholder model, the CEO becomes the facilitator of the interests of the various stakeholder groups rather than simply aiming to increase returns for shareholders. Evan and Freeman propose two principles for the management of such a firm. First, the firm should be managed for the benefit of its stakeholders, to protect their rights and ensure that they participate in decision-making. Second, management bears a fiduciary duty to these stakeholders as well as to the corporation as an abstract entity (1988/1993 p262).

But is it possible to implement this idea in practice? Can a corporation actually 'serve the public' given what is 'rewarded and demanded by the free market system' as Solomon believes? Can a CEO really facilitate the interests of all stakeholders as Evan and Freeman suggest?

CSR is impossible

We have now reached the central issue. It is clear corporations acting solely in their self-interest cannot be considered 'ethical'. In response, some commentators contend that corporations can go beyond self-interest. However, in respect of public corporations this view is problematic for two reasons. First, corporations are constrained by competitive markets. Second, they are constrained by their legal construction.

When most business ethicists cite Friedman, they consider only his normative position (discussed above). However Friedman also made a positive claim regarding the limitations on corporate non-profit maximizing behavior:

> And, whether he wants to or not, can he [the manager] get away with spending his stockholders', customers' or employees' money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibility (1970/1993 p. 251-252).

Friedman suggests a business significantly deviating from profitable activities will not survive for long. A business might be able to 'get away' with a one-off gesture, such as when Merck developed and distributed Mectizan (a cure for river blindness) or when Levis exited China due to concern for human rights However, the capitalist system enables those who believe they can better manage the assets of a corporation to make a takeover bid for the company. A company engaging in significant non-profit maximizing activities will have lower profits and a lower stock price. A profit-driven investor can simply purchase this stock, eliminate the non-profit maximizing activities and reap the benefits of a substantially improved stock price. As capital markets are efficient (Ross, Westerfield, and Jaffe 2002 p. 349), non-profit maximizing firm will eventually be driven to a profit maximizing position.

The problem is illustrated by the example of the Body Shop. Founded in 1976 by Anita Roddick, the Body Shop was intended to both contribute to various social and environmental causes as well as provide an example of how 'progressive' businesses could be run. In her book *Business as Unusual* she claims 'corporations operating globally can change the system to encourage trade that is fair, sustainable and devoted to good husbandry of the Earth's resources' (Roddick 2000 p28). However, after the Body Shop was listed on the London Stock Exchange in 1982, debate over the priority of financial versus non-financial objectives grew. A 'professional' CEO was brought in to manage the business in the mid-1990s, though at the time Roddick contended that the company's social and environmental agenda would continue unhindered. However, when Roddick believed the company should oppose the World Trade Organization following the Seattle protests she was unable to implement this policy. Roddick now believes her agenda cannot be achieved through a public company – she describes the stock market floatation as a 'pact with the Devil . . you go into the stock market and the imperative is to grow – and by a small group of people's standards, financial investors who are gamblers . . . ' (Bakan 2004 p52).

Arguably even more powerful than competitive markets is the legal obligation of managers to put the interests of the stockholders first. Evan and Freeman (1988/1993) explain:

> The law of corporations gives a relatively clear-cut answer to the question: In whose interest and for whose benefit should the modern corporation be governed? It says that the corporation should be run in the interests of the stockholders in the firm. Directors and other officers of the firm have a fiduciary obligation to stockholders . . . since the corporation is a legal person, existing in contemplation of the law, managers of the corporation are constrained by law . . . [which has] guaranteed that the claims of customers, suppliers, local communities, and employees are in general subordinated to the claims of stockholders . . . (p255-256).

This principle has been enshrined by the courts in a number of decisions over the years. One of the earliest, ironically enough given the Pinto example mentioned above, involved Ford. In 1916 Henry Ford wished to use the profits of the company to lower prices to customers rather than pay dividends. The Dodge brothers were major shareholders of the company and were planning to use the dividend payments to start their own automotive firm. The judgement in *Dodge v. Ford* held that the company had to put the interests of shareholders first – what has become known as the 'best interests of the corporation' principle (Bakan 2004 p36). Though the judgement was in favour of Ford (as reinvesting rather than distributing dividends is not illegal), the judgement stated that 'a business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among shareholders in order to devote them to other purposes' (Dodge v. Ford Motor Co. 1919). Managers must put shareholders first.

This principle means a stakeholder-driven corporation is illegal. Evan and Freeman (1998/1993) argue that regulations increasingly protect the interests of stakeholders. This may be so, but the important principle is that the firm is being managed for the benefit of the stockholders subject to these regulations. As The Economist points out:

> Of course it is always possible, as a matter of law, to create forms of managerial accountability to non-owners. Through the courts, you might say, managers are held accountable to society at large. Public policy can make managers accountable to regulators. Managerial accountability to workers can also be required by law: worker representation on company boards is mandated in Germany, for instance . . . but all such lines of accountability recognise owners as primary. You cannot deem stakeholders to be equal co-owners of a business without repudiating the very idea of ownership. And where the law does not create accountability to non-owners, there is none (The Economist 2005a b p21).

Even Evan and Freeman concede the present laws would have to significantly change in order to create a stakeholder-driven firm (1988/1993 p264-265).

One response to this position is to argue that even if the firm must be run on behalf of shareholders, it does not necessarily follow that all shareholders are profit-maximizing entities. This argument, however, is problematic. First, the majority of shares are held not by individuals but by other corporations (such as insurance companies) and fund managers. From the discussion above it is clear that corporate investors will seek profit maximization. Fund managers compete with each other on the basis of returns in order to attract investors and therefore also demand maximum corporate profitability. So-called 'ethical' funds do not provide an exception to this rule. They claim investors do not have to sacrifice returns in order to invest ethically and hence must also demand corporate profitability. This fact combined with the very small size of the ethical investment sector suggests it is unlikely to significantly alter corporate behavior for the foreseeable future (Haigh and Hazelton 2004).

Finally, even with respect to individual investors, a public corporation faces a dilemma in deciding to take an ethical position. Given the voluminous literature on the subject it is clear there is no universal conception of ethics. How would a corporation know what its shareholders preferred when faced with a choice between increasing spending on recycling, improving opportunities for disabled employees or contributing to the local community sports club? Even if it conducted a survey of its shareholders there would be no guarantee that the same shareholders, and hence ethical preferences, would continue in future.

Thus when Kofi Annan stated at the 2002 World Summit for Sustainable Development 'we are not asking corporations to do something different from their normal business, we are asking them to do the normal business differently' (United Nations 2002), it was impossible for business to heed the call. In an analysis of business activities since the Summit, LeVeness and Primeaux (2004 p193) suggest there has been little attitudinal or behavioral transformation. They cite 'unyielding commitment to increasing shareholder value in the short term' as the key barrier to change. Given the commercial and legal constraints discussed above, this finding is hardly surprising.

Conclusions and implications

The analysis above suggests public corporations will be profit-maximizing entities. Corporations therefore cannot act in a genuinely ethical way (and the only way they can be unethical is to deviate from this profit maximizing position). For all practical purposes, therefore, public companies are amoral. (The position with respect to private companies is similar but due to more concentrated ownership, non-profit maximizing preferences of their owners may be more readily translated into their activities. However such instances will be rare). We might not like this. We might feel that public companies have great ethical responsibility because of their power. We might even have many business ethicists on our side. But this is not going to change the fact that large companies are unlikely to substantially deviate from profit maximizing behavior, and that this will inevitably lead to adverse social and environmental outcomes.

There are two ways to alleviate these adverse outcomes. The first is to improve the regulatory process, particularly at the trans-national level. The second is to look beyond the corporate form as the main organizational structure for economic development.

If we accept corporations will profit-maximize within the legislative framework, the quality of this framework is obviously of paramount importance. From the discussion above the corporate 'capture' of the regulatory process was identified as particularly problematic. Given their resources, the corporate sector has a natural advantage in their ability to lobby politicians. In the US, Bakan (2004 p103) notes that 'in the mid-1970s the Supreme Court extended First

Amendment constitutional protection to corporate funding of elections, a decision that opened the door to corporations' near-complete takeover of the electoral process'. Even some shareholders find such donations unpalatable – in 2004 the Australian Shareholders' Association (unsuccessfully) called for a ban on political donations by listed companies, stating they effectively amount to a bribe and taint the democratic process (Percy 2004). Around the world, restrictions on corporate political donations are rare - in a survey of 104 countries Pinto-Duschinsky (2002) found only 16% had either partial or complete bans on this practice.

The other area of particular weakness is trans-national governance. This was recognized as far back as Kant. His *Idea for a Universal History with a Cosmopolitan Purpose* (1787/1991 pp. 41-53) conceptualizes humanity's past and future as a gradual progression towards the 'cosmopolitan purpose' of creating a civil society able to administer justice universally. Only such a society enables full realization of the capabilities of humanity – but it requires global rules. Other Kantian philosophers such as Rawls agree:

> The idea of a reasonably just society of well-ordered peoples will not have an important place in a theory of international politics until such peoples exist and have learned to coordinate the actions of their governments in wider forms of political, economic and social cooperation (Rawls 2001 p19).

The United Nations (UN) is the obvious candidate for creating and enforcing global governance and has a long history of advocating universal human rights. Indeed, perhaps the most famous UN document is the *Universal Declaration of Human Rights* proclaimed by the General Assembly in 1948. The UN has also focused on issues of social justice and the environment under the broad heading of 'sustainable development'. Activities in this area began in 1972 with the first UN conference on the Human Environment followed by World Summits on Sustainable Development in 1992 and 2002. The UN has largely adopted a Kantian position on the universality of rights and the goal of creating a global civil society.

However the UN primarily plays a facilitative role among nation states, and with little authority its principles are not universally administered. Binding targets from the Summits, such as the Kyoto Protocol, have been ignored by countries such as the US and Australia, as it is not in their national interest to comply. If the UN and its agencies are ignored or bypassed by powers such as the US this obviously undermines the ability of the UN to provide effective global governance. (Tharoor (2005 p15) explains the competing paradigms at the heart of this issue.) In addition, the UN is not immune to corporate capture. Bruno (2005) suggests that as the UN has been starved for funding by nation states it has turned to the group with the best resources – multinational corporations – for assistance. Through initiatives such as the Global Compact, corporations can agree to non-binding targets and in receive UN endorsement in return. It is no wonder Nike CEO Phil Knight is smiling while shaking hands with Kofi Annan in the photo accompanying Bruno's article. Ma'anit (2005) discusses the case of the Kyoto protocol and suggests powerful corporate lobby groups have created a relationship of 'partnership' with the UN rather than being subject to environmental governance. Indeed, Ma'anit believes the 'bias of the UN is less about succumbing to corporate pressure and more about pursuing corporate-friendly solutions as a matter of course' (p19). Ransom (2005 p11-12) reports that in Iraq: 'the UN has been paying Halliburton $18 million, Bectel $7 million and Nestle $2.6 million, through its Compensation Commission. All told, more than $21 billion of Iraqi oil revenues have been quietly handed over to Western oil companies since 1991. "This is the first time, as far as I know," comments Claude Aime, who headed the Commission until 2000, "that the UN is engaged in retrieving lost corporate assets and profits".'

In terms of global governance, another critical body is the World Trade Organization (WTO). The WTO has achieved a greater degree of authority over nation-states and multinationals than the UN (albeit within a limited scope). The WTO administers a binding dispute resolution system, with trade sanctions imposed if the WTO panel rulings are not followed (World Trade Organization 2003). However, issues such as environmental protection and worker rights are outside the scope of the WTO (developing countries actually opposed introduction of minimum working conditions via the WTO fearing they would become a smokescreen for protectionism). Therefore, while embodying the principle of universality, the main rights being upheld by the WTO are property rights. Singer (2002 ch3) acknowledges the WTO has in the past placed economic considerations above social and environmental concerns. However, he believes that due to its power, the WTO could in the future pursue these objectives or another body constituted to take its place:

> we could in time come to see the WTO as a platform from which a policy of laissez-faire in global trade is replaced by a more democratically controlled system of regulation that promotes minimum standards for environmental protection, worker safety, union rights and animal welfare . . . [if not] it would be best for its scope to be curtailed by a body willing to take on the challenges of setting global environmental and social standards and finding ways of making them stick (p106-107).

Perhaps the European Union (EU) is the closest modern embodiment of an effective international legislative body constituted along social democratic rather than libertarian lines. Like the WTO, the concept of the EU originated in trade but also included the hope that the organization would help unite World War II antagonists. The modern EU is much more than just a trading bloc - the European Parliament (elected by citizens of member states since 1979) enacts laws which directly impact the millions of EU citizens. For example, in the area of human rights the EU equivalent of the UN Declaration is the *Charter of Fundamental Rights of the European Union* (European Union 2000). This document is much more specific than the UN equivalent, including clauses that 'no one shall be condemned to the death penalty, or executed' (Article 2), 'the reproductive cloning of human beings is prohibited' (Article 3), 'the right of every worker to minimum working hours and paid holidays' (Article 31) and so on. In addition, the EU has an annual independent review of its performance in ensuring the actualization of these rights for all its citizens (see for example the comprehensive 2003 review by the EU Network of Independent Experts on Fundamental Rights (2004)). The EU also redistributes wealth from richer to poorer member states in the form of infrastructure grants to create roads, railways and so on.

While the EU may provide an example of effective trans-national governance, from the discussion above it is apparent that laws alone can never be the answer. There will always be delays, loopholes and corporate capture of the political process. Given the inherent limitations of the corporate form, an important question is whether economic activities must necessarily operate within it or whether other organizational structures provide greater scope for ethical conduct.

Given the current prevalence of corporations it is easy to forget they are a relatively recent phenomenon. Corporations date from the East India Tea Company (est. 1600) and Sumitomo (est. 1590), but only began to be created in large numbers in the last 150 years. Other organizations created long before the first corporations still survive such as Oxford University (established around 1100) and Cambridge University (established 1209). Such institutions have been labelled non-government organizations (NGOs) but could just as easily be thought of as non-corporate organizations. While the term 'NGO' typically brings to mind charities and advocacy groups such as Oxfam, Amnesty International and Greenpeace, it also encompasses organizations such as mutual associations, credit unions and cooperatives. The last twenty years have seen the increasing rise of both the numbers and influence of NGOs - between 1990 and 1999 the number of NGOs grew from 6,000 to over 26,000 (The Economist 1999). In the corporate-centric West we might be surprised to learn that a significant proportion of the world's workers - over 750 million people – operate within cooperatives (Sanchez 2004).

NGOs are created for a particular purpose, and while NGOs obviously require financial resources to operate, they do not have to maximize profits. NGOs are not vulnerable to hostile takeovers as their ownership is not for sale on capital markets. These characteristics mean that NGOs, unlike corporations, have the potential to act in a genuinely ethical manner. Given that such organizations are established to serve a purpose other than pure self-interest, they may meet the tests for acting ethically under the Kantian framework as discussed by Sorrell and Hendry (1994), Community-focused NGOs may also meet the criteria for acting ethically under a utilitarian framework.

NGOs are also much closer both ideologically and legally to the Evan and Freeman stakeholder model discussed above. Ideologically, though most NGOs focus on a specific issue, in order to achieve their goals they require the coordination of the interests of their stakeholders. Legally, there is no requirement for NGOs to prioritize the financial interests of their members. Therefore managers of NGOs are in a position where they can adopt Evan and Freeman's mandate as facilitators of stakeholder interests.

In the economic sphere, though some charitable and advocacy groups sell goods (t-shirts, Christmas cards etc.), by far the most important organizational type is the cooperative. Indeed Mill (1909 IV.7.21) believed that if mankind was to improve, the cooperative 'must be expected in the end to predominate'. Former Costa Rican President Oscar Sanchez is an outspoken advocate of cooperatives and believes they embody a new ethic of solidarity, honesty, transparency, faith and compassion. Sanchez elected to use the cooperative structure in preference to a corporation when privatising CASTA (a state-owned sugar enterprise) as 'it was clear that selling this enterprise to private investors would have concentrated the profits in a few hands and the benefits to Costa Ricans would have been negligible' (Sanchez 2004 p34). Cooperatives are not limited to the developing world - the Mondragon cooperative in Spain employs 68,000 people and is Spain's seventh largest business organization ranked by sales volume (Mondragon Corporation Cooperative 2001 p27-28).

Of course, if we accept the proposition that, unlike corporations, NGOs have the freedom to act ethically, we must also accept they have the ability to act unethically. Recently NGOs have been the subject of much criticism – see for example Roy (2004) and Shamir (2004). Nevertheless, alternate organizational forms such as the cooperative are worthy of serious consideration as an alternative to the flawed corporate model.

We have shown that the public corporations (and most private corporations) are inherently limited in their ability to act ethically and are best considered amoral entities. Given the size and power of corporations, this poses significant challenges for society. However, we believe improved regulation (especially at the trans-national level) and the use of non-corporate organizational forms hold promise for delivering economic progress without the adverse social and environmental outcomes typical of corporate activities.

Author affiliations

* Corresponding author

* James Hazelton is a Lecturer in Accounting, Division of Economic and Financial Studies, Macquarie University, Sydney, New South Wales 2109, AUSTRALIA. Tel: +61 2 9850 8486. E-mail: james.hazelton@mq.edu.au

Ken Cussen is a Lecturer in Environmental Ethics, Graduate School of the Environment, Macquarie University, Sydney, New South Wales 2109, AUSTRALIA. Tel: +61 2 9850 7973. E-mail: ken.cussen@mq.edu.au

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24 February 2006

John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

CAMAC Inquiry into Corporate Social Responsibility and Directors' Duties

Dear John,

Futureye is pleased to respond to a number of the key issues discussed and questions posed by the CAMAC Discussion Paper on Corporate Social Responsibility (CSR).

Futureye is fortunate to have had previous involvement with this CAMAC inquiry, in the form of a roundtable we arranged to facilitate discussion between yourself and a number of our corporate clients who are engaged in implementing CSR strategies and approaches within large Australian corporations.

Futureye has also previously made a submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility. That document addresses many of the broad themes covered by the CAMAC enquiry.

This response should thus be read as a supplement to the Parliamentary Joint Committee Submission,
providing further detail on specific questions posed by the CAMAC Discussion Paper. These supplementary comments will focus on two key areas: directors' duties and sustainability reporting.

In the responses below, questions posed in the CAMAC paper that Futureye has selected for response are highlighted in the blue break-out boxes.

About Futureye

Futureye is a strategic advisory firm that helps organisations to address the challenges of sustainable development. Our clients include a wide range of large domestic and major multinational corporations, primarily in the mining, energy resources, forestry, pharmaceuticals, banking and telecommunications industries. We also undertake a broad range of work for government departments and authorities, and government-owned enterprises.

Futureye provides specialist research, communication, strategic planning and stakeholder engagement services to develop proactive organisations that will succeed in the new stakeholder era. Our clients earn greater trust and become more responsive to their major risks and opportunities, meeting changing expectations of organisational behaviour.

Futureye's direct experience in assisting organisations in meeting new expectations means we are well placed to give comment on the matters set out in the CAMAC Discussion Paper.

Key Issue 1: Directors Duties

- *Do companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions?*
- *If so, is there any useful scope for clarifying the current law in this respect?*
- *Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?*
- *Should the Corporations Act be revised 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?*

Discussion amongst executives at the CAMAC round table hosted by Futureye indicated that in general, executives with responsibility for driving CSR initiatives and approaches do not feel that directors' duties, either under common law or under the Corporations Act, present a barrier to advancing a 'CSR agenda' within their companies. This view has also been shared in most responses by large Australian corporations to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry on Corporate Responsibility.

Other executives and directors, however, have suggested that there are times when current requirements on directors do prevent them for addressing the full range of social and environmental costs and impacts created by their business, where they are not obliged under law to do so. Most prominently, Meredith Hellicar, Chair of James Hardie, has taken an advocacy role on this issue. She has suggested that the actions of James Hardie directors in severing the company's asbestos-related liabilities from its balance sheet were motivated from consideration of the directors' legal responsibilities to their shareholders, and called for changes to the Corporations Act to enable a more enlightened approach:

> *What one needs is a safe harbour for directors to be able to integrate corporate social responsibility into their decision making without fear that they are going to be sued both personally, and as a company, by their shareholders.*[1]

With the company's establishment of the Special Purpose Fund to meet future asbestos liabilities, Hellicar has suggested that even with approval for the plan by a

[1] Bill Phesant, 'Directors Need a Safe Harbour: Hellicar', *Australian Financial Review*, 17 March 2005, p3.

majority of shareholders, “there is no doubt of the threat of a shareholder suit”[2] against the directors from minority shareholders who do not agree. UNSW law professor Paul Redmond has supported Hellicar’s call, stating that there is ‘no clear licence in the current law’ for directors to internalise external costs and impacts where they are not obliged by law to do so.[3]

The James Hardie example is a poignant reminder of just how narrow the views of shareholder value and corporate ‘best interests’ applied in Australian corporate boardrooms can be. It illustrates the clash between traditional views of directors’ duties, and the broader expectations of society. In many ways, the high cost of the James Hardie incident, to both society and the firm, is directly traceable to a long-term failure by the company to take stakeholder views or impacts into account. The company clearly failed to recognise the direct costs in terms of legal and reputational liability, consumer boycott, government intervention and ultimately share price, that such failure could exact.

A more transparent approach by James Hardie at a much earlier date would have seen the company disclose all negative impacts of their products and operations as they became known, publicly declaring the dilemmas involved and working with stakeholders to address the issues. Whilst such an approach might have had a higher initial cost to the firm, there can surely be little question that, had it effectively managed its stakeholder-related risks as they arose, the company would find itself in far better position in the present time. A company more focussed on its stakeholders would have been better placed to create long-term shareholder value.

Traditional views of shareholder value and corporate ‘best interests’ are woefully inadequate in the present time. They meet neither society’s best interests, nor the long-term best interests of shareholders. Whilst broader interpretations of these concepts may not be directly prevented by existing legislation on directors duties, it is important to point out that neither does the status quo encourage such broader considerations.

Futureye therefore submits that changes to the Corporations Act to elaborate on the considerations that should made by directors with regard to stakeholder interests, long-term value, and intangible assets like corporate reputation, seem warranted.

- *Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors’ duties?*
- *Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?*
- *If an elaborated shareholder value benefit approach were to be adopted:*
  - *what form should it take?*
  - *would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments?*

With regard to the approach taken in any such changes to the Corporations Act, Futureye supports an elaborated shareholder value approach.

[2] Fiona Buffini, ‘Calls to protect corporate conscience’, *Australian Financial Review*, 13 November 2005, p3.
[3] Ibid.

In the wake of a wide range of corporate scandals, in which profit-focussed corporate behaviour has been demonstrated to fall far short of community expectations, a pluralist approach to directors' duties has evident attractions in requiring directors to consider a broader range of interests in making key decisions.

The pluralist approach, however, suffers from seemingly insurmountable pitfalls. Attractive as it is, it seeks to replace a clearly defined, well understood and enforceable legal accountability with one that is ill-defined and unenforceable.

Further, as a number of critics have pointed out, the dilution of the profit-maximising principle in directors' duties has significant potential implications for the effective operation of a wide range of goods and capital markets. Profit maximisation is, of course, regarded by orthodox economic theory as fundamental principle by which markets achieve efficient resource allocation.

Many contemporary market mechanisms are of course imperfect, as they externalise costs borne by the environment, particular non-shareholder stakeholders, and society as a whole. Nonetheless, most would argue that the appropriate mechanism to correct such problems is improved regulation and enforcement with regard to corporate social and environmental conduct. Effective regulation has the power to improve the operation of markets by accurately pricing in otherwise externalised costs. By contrast, redefining the purpose of the corporation to focus less on profitability and shareholder value, and more on the broadly-defined needs of other stakeholders, has the potential to undermine market efficiency, by diluting the extent to which decisions are made on the basis of 'rational self-interest'.

Finally, it is also unclear how much impact such a pluralist approach would in fact have on corporate behaviours. As Bill Beerworth has pointed out, it is financial markets and the incentives that they offer, rather than the dictates of directors duties, that are the most powerful force in shaping corporate behaviour:

> *Most have deeply absorbed the principle of shareholder primacy, which holds that the primary goal of management is to maximise shareholder wealth without undue concern about other interests except to the extent required by corporate reputation and the expectations of customers. The architecture of corporate capitalism is predicated on this objective and the model is sanctified by the securities market. Corporations are ranked in accordance with the financial returns they provide or are likely to provide. Companies that provide superior returns attract premium market prices. They can easily raise new capital, and its cost falls.*[4]

Ultimately, it is the operation of financial markets, more than it is the requirements of directors' duties, that shapes the primacy of shareholder value creation as the overarching aim of corporations. Efforts that seek to improve the consideration given by corporate decision makers to a company's impacts on non-shareholder stakeholders must work within a framework compatible with that of market decision making if it is to achieve genuine results.

In Futureye's submission to the Joint Parliamentary Committee Enquiry, we have pointed out what we view as a need to further focus company directors and management on the creation of long-term value, and on the creation of long-term alignments between shareholder and stakeholder interests. It is becoming

[4] Bill Beerworth, 'Corporate social responsibility turns off investors', *Australian Financial Review* 11 November 2005, p75.

increasingly clear that in the long-run, ability to meet increasing community expectations of corporate social and environmental performance is the fundamental factor determining a company's licence to operate, in establishing reputation and brand equity, in determining its ability to attract and retain talented staff, and in shaping the regulatory environment in which corporations operate.

An elaborated shareholder value approach to directors' duties could have a major impact in focusing directors on these issues. The power of such an approach lies in requiring directors to consider the long-term impact of their decisions, and the strategic risks and opportunities that are presented by social and environmental impacts and changing community expectations.

The virtue of such an approach is the effective balance it strikes between a prescriptive and a permissive approach. While it does not prescribe a direct duty toward non-shareholder stakeholders, it does more than merely permit consideration of their interests. By requiring directors to have consideration for these impacts in making decisions about shareholder value, the elaborated shareholder value approach makes explicit the impetus for creating long-term value by aligning shareholder and stakeholder interests.

Futureye thus generally supports the *UK Company Law Reform Bill* as an appropriate precedent for change. It represents a well-considered attempt to establish an elaborated shareholder value approach. Additionally, as the Public Interest Law Clearing House (PILCH) has identified in its submission to the Joint Parliamentary Inquiry, adoption of the approach taken in the UK Company Law Reform Bill would "reduce some of the uncertainty relating to the new formulation of directors' duties by giving Australian company directors the benefit of both Australian and United Kingdom jurisprudence in informing their decision-making".

The provisions of the *UK Company Law Reform Bill* as a precedent for change might be further strengthened by an additional requirement on directors to ensure regular consultation with local communities in relation to all activities that have a significant impact on the natural environment.[5] Requiring such consultation might be one means of ensuring that companies with significant environmental impacts better understand the nature of their social licence to operate, and the strategic threats and opportunities arising from changing community expectations of their performance.

Key Issue 2: Sustainability Reporting

- *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*
- *Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities?*
- *Are any changes desirable to any other reporting requirements, such as the ASX Listing Rule requirements, the ASX Corporate Governance Principles or relevant accounting standards, to provide more relevant non-financial information to the market?*
- *In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form?*
- *Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles?*

[5] Proposed in the submission to the Joint Parliamentary Inquiry by Dr Anthony Forsyth, Monash University.

Reporting on sustainability / social and environmental performance is a major tool for encouraging a focus on long-term value and hence on stakeholder interests. The key value in sustainability reporting lies in the 'materiality' of a report – the extent to which it provides transparent data and information that matches the concerns of the stakeholder audience to which it is targeted.

As sustainability reporting has mushroomed in recent years, too many reports have been produced that have been one-size fits all documents, full of the data required by standards such as the Global Reporting Initiative, but failing to adequately address the fundamental concerns held by an organisation's stakeholders.

In order to produce sustainability reports that accurately reflect stakeholder concerns, corporations must engage those stakeholders in order to understand what the issues of concern to them are. They must then ensure that these are adequately reported on in a manner deemed by the Board to be transparent – that is fully disclosing all known negative social and environmental impacts of interest to stakeholders. Stakeholders engaged in this process should include:

- Employees;
- NGOs/activists;
- Investment community;
- Industry;
- Customers;
- Communities in which they operate; and
- Government.

Above all, effective sustainability reports must demonstrate that the impact of decisions on long-term value are being incorporated into strategic planning and decision making. This should include an analysis of risks in regard to stakeholder expectations, and the impact of these on long-term value. It should also include demonstration of engagement by senior corporate leadership with questions regarding the long-term changes required to create more sustainable business models.

Genuinely 'material' reporting by all large corporations would promote corporate learning, reflection and innovation, encouraging corporations that have not yet recognised the impact of stakeholder concerns on long-term shareholder value to engage with these issues.

Such reporting, if undertaken by all large corporations, would also be a significant tool in improving the information available to financial markets about the long-term risks and benefits associated with social and environmental performance. Such a move, when viewed in conjunction with the adoption of social and environmental screening practices in mainstream investment practices that is already beginning to occur, could be a major influence in improving corporate focus on long-term, 'enlightened' shareholder value, and thus on improving the extent to which stakeholder concerns are considered and acted on in organisational decision making.

Futureye therefore supports a mandated requirement for all large corporations to report annually on social and environmental impacts. Where reporting is not mandatory, it seems reasonable to expect that only 'good' performers will seek to take it up, as a strategy to build or protect their reputations. It is arguable, however, that it is through full-disclosure by the poorer corporate performers that society has the most to gain. Under the current, purely voluntary approach, these companies seem to be the least likely to report.

Reporting effectively on social and environmental impacts is a resource intensive activity and one which, as a result, is appropriate to enforce on large, publicly traded businesses, though not on small-to-medium enterprises (SMEs). One obvious means of enforcing such requirements solely on publicly traded companies would be to incorporate them into ASX listing requirements. As the CAMAC Discussion Paper notes, this approach has already been taken in South Africa, where companies listing on the Johannesburg Stock Exchange (JSE) are required to report annually on a range of social and environmental issues, using the Global Reporting Initiative (GRI) framework as a basis.

For the purpose of providing meaningful information to financial markets on social and environmental risks and opportunities, it is vital that reporting should occur in a way that enables direct comparison between companies. The GRI currently represents the most useful available tool in this regard. The GRI provides a useful benchmark on key social and environmental impacts that should be addressed in any thorough sustainability report, as well as providing guidance on how impacts should be reported. The widespread adoption of the GRI standard in recent years makes it the best available standard to ensure comparability.

In its current form, however, GRI compliance does little to ensure that companies are focussed on addressing the issues of greatest concerns to relevant stakeholder groups. Nor does GRI compliance require companies to show that reporting is being used as a means of corporate engagement with the risks and opportunities posed by social and environmental performance. As a result, Futureye recommends that any mandated reporting requirements should also focus on:

- Requirements to ensure that such reporting addresses the principle impacts and issues of concern to relevant stakeholder groups;
- Requirements to ensure that reporting is transparent, fully disclosing known negative social and environmental impacts of interest to stakeholders or of potential relevance to balance sheet considerations (ie potential future risks/liabilities/increased costs);
- Requirements to ensure that reporting examines the threats to and opportunities for long-term value posed by such impacts; and
- Requirements to report on governance approaches to the management of stakeholder-related risks, including mechanisms for disclosing negative impacts, sharing dilemmas, consulting communities and stakeholder groups, and resolving complex issues;
- Requirements to ensure that reporting includes an examination of the longer-term changes to strategies and business models needed to minimise such risks in the future.

Concluding Remarks

Futureye makes the above comments as the result of significant experience working with leading corporations on issues of social responsibility, sustainable development, and stakeholder engagement.

We would be happy to discuss any of these issues further with the CAMAC.

Katherine Teh-White
Managing Director

Corporations and Markets Advisory Committee
Australian Securities & Investments Commission

Corporate Social Responsibility

Submission by the Australian Society of Archivists

The Australian Society of Archivists (ASA) is the professional organisation in Australia representing archivists and recordkeepers. Information about ASA aims, membership, and activities are set out at Attachment A.

The ASA has for some time been exploring opportunities to make clearer the relationship between records and archives, good governance, and corporate social responsibility, and therefore welcomes the opportunity to provide input to the Committee's consideration of this matter.

For any questions on this Submission, please contact Catherine Robinson, President, at asapresident@emailme.com.au or tel. (02) 8247 8631.

Records and Archives

Records are fundamental to the operation of business. Records are defined as "Information created, received, and maintained as evidence and information by an organization or person, in pursuance of legal obligations or in the transaction of business"[1]. Records provide the basic information for understanding the operations of a corporation. Reliable records are an important part of responsible business, and they are also critical in demonstrating that responsibility. Many business records, such as financial records, policy records, and other evidence of corporate decision-making are subject to regulation requiring their creation or retention, to allow scrutiny of corporate affairs.

The importance of recordkeeping as a key operational element of good governance was recognised in the Australian Standard AS 8000 – 2003: Good governance principles.[2]

Archives are those records deliberately identified for ongoing preservation to meet long-term interests of an organisation or community. Archives are unique and provide us with evidence of past actions, past decisions and our identity. Archives contribute to the collective memory of society and assist in providing a deeper cultural and social understanding of the communities and the broader society. Australia's archival heritage gives a sense of who we are, where we come from, and the diverse communities that constitute our society. The archives of corporate Australia are a significant part of that heritage, and recognised as such by socially responsible businesses.

Key Issues

The ASA notes that many of the approaches under consideration, and in use in other jurisdictions, are based on reporting and disclosure requirements. Section 4 of the Discussion paper addresses these matters in some detail. Access to adequate information for shareholders

[1] AS ISO 15489.1 - 2002, *Records Management Part 1: General*, Clause 3.15

[2] AS 8000 – 2003, *Good governance principles*, Clause 2.3.4

and the wider public to make judgements about the actions of a corporation is an important component of responsible actions. Numerous references are made in the discussion paper to the audit of such reports, statements and disclosures. This highlights the fact that this information is based on business information created, or collected in the course of the corporation's activities, in other words, its records.

The ASA wishes to emphasise that all such information-based regimes are fundamentally based on the existence and reliability of business records. Good corporate recordkeeping is an essential precondition to demonstration of responsibility in this way. Equally, good records will enable the identification of irresponsible action by auditors or others charged with such investigation.

In particular sustainability considerations frequently require access to historical information for comparative analysis. For valid analysis it is necessary to be able to accurately interpret the historical data. This too requires robust recordkeeping to enable the correct interpretation of information over time.

The ASA notes that good recordkeeping practice is increasingly well articulated in a range of standards such as AS/ISO 15489 Standard on *Records Management*. These standards are, in our view, an important underpinning of corporate social responsibility.

The ASA notes that many of the current rating indexes for Corporate Social Responsibility do not place much, if any weight, upon an organisation's good corporate recordkeeping. Yet, it is quite clear from the Australian Standard AS 8003 – 2003; *Corporate Social Responsibility*, that recordkeeping informs the corporate social responsibility program (Clauses 3.5 and 3.7) and is a part of the key issue of Governance, considered in managing corporate social responsibility issues (Clauses 5.2.1 (b) and 5.2.5). The ASA would like to see a greater emphasis given to recordkeeping in assessments of corporations and companies' corporate social responsibility.

The ASA also considers that awareness of a corporation's long term impact on the environment, economy, and communities, with which it interacts, is an important component of social responsibility. A responsible business recognises its legacy, and its part in the history of the community and the country. One means of demonstrating this is through the management of corporate archives.

The ASA notes that business archives are a valuable resource for a range of researchers seeking to understand the development of Australia's society, its economy and industries. Information about the range of business archives currently being preserved in Australia is available in the Guide to Australian Business records at http://www.gabr.net.au/gabr_home.html

The importance of business archives, and their relationship to corporate social responsibility has been identified in a major report by the International Council on Archives' Section on Business and Labour Archives (emphasis added):

> "[H]ow do we persuade executives that it is a good idea to keep company records and open the company archives to the public?
>
> One line of argumentation would be that of moral obligation to the large community. We could point to the cultural value of the records, stressing the importance of the company as part of the national heritage. We could explain that **a commitment to retain the records and open the archives demonstrates a high ethical standard and conveys an image of social responsibility**.… A company has much to gain by keeping an archive and making the historical records available to the public. **It will**

> **establish a reputation of social responsibility and transparency by opening historical information** to customers, collectors, documentary film makers, descendants of employees, students, historians and other public sectors with an interest in the company's past."

An extended extract from this report is provided at Attachment B.

Conclusion

Records provide the reliable evidence of corporate action necessary to allow proper evaluation of corporate action. The ASA urges recognition of this dependency in any approach taken to corporate social responsibility. We consider corporate archives to be a means by which businesses can recognise their impact on the community, and urge the adoption of policy that recognises and promotes the contribution of archives to Australian society.

Attachment A

About the Australian Society of Archivists Inc.

The mission of archivists is to ensure that records which have value as authentic evidence of administrative, corporate, cultural and intellectual activity are made, kept and used. The work of archivists is vital for ensuring organisational efficiency and accountability and for supporting understandings of Australian life through the management and retention of its personal, corporate and social memory.

The Australian Society of Archivists Inc. (ASA) is the peak professional body for archivists in Australia. It was formed in 1975 in response to the growing number of archivists in Australia and to the increasing demand for archival skills. The Society is administered on a national basis by an elected Council. Branches and Special Interest Groups, including the Indigenous Issues Special Interest Group, are active in the States and Territories. The Society has some 850 members, largely employed by government agencies and business organisations.

The objectives of the Australian Society of Archivists are to:

- promote a professional identity amongst archivists;
- promote the keeping care and use of archives and encourage research and development in all areas of archival practice;
- establish and maintain standards of archival practice and professional conduct amongst archivists, including standards of archival qualifications and professional training;
- encourage the responsible use of archives including cooperating with other organisations and groups with common interests and concerns;
- encourage communication and cooperation amongst archivists, their institutions and the users of archives; and
- publish and disseminate information relevant to the archival profession.

Further information about the Australian Society of Archivists' activities is available at www.archivists.org.au

Attachment B

Business Archives in International Comparison

August 2004

http://www.ica.org/biblio/SBL25082004.pdf

"[H]ow do we persuade executives that it is a good idea to keep company records and open the company archives to the public?

One line of argumentation would be that of moral obligation to the large community. We could point to the cultural value of the records, stressing the importance of the company as part of the national heritage. We could explain that a commitment to retain the records and open the archives demonstrates a high ethical standard and conveys an image of social responsibility. This all is very true, but it would not be sufficiently persuasive.

What really counts is the bottom line. And here we are, back again, caught in the middle. If considerations of private property, including business records, in the last resort are judged solely by their influence on the bottom line, then there is a real risk of violating the democratic right to have access to information. If bottom-line considerations are the guideline for handling business records, the overall view of appraisal would be to keep only the nice records and get rid of all the unpleasant ones. And that would be actively trying to distort history. This approach, of course, has nothing to do with the truth and even less to do with the whole truth.

In addition to their value to the business enterprise, business records have a cultural value that cannot be measured in dollars or euros or any other currency. They are part of the national heritage and ought to be kept and made publicly available for that reason. Business archivists must state that clearly when trying to persuade the CEOs and decision makers of companies.

This only makes the task of persuading companies to keep their records even more difficult. Yet, it has to be done. And to some degree, it is possible to do so. There are good reasons for a company to keep its records and make them available to the public even though the only apparently measurable economic impact is to increase expenses.

Let us look at some of the irrefutable reasons for companies to keep their records:

- Financial and legal documentation: This is an obvious need. A company has to keep all records that can be used to document the fulfilment of its obligations in terms of contracting, testing, technical documentation and the like. Record keeping is important for the protection of trademarks and other intellectual property rights and also, of course, for litigation support.

These are perhaps the most obvious reasons for keeping records. But there are also – at least – five other needs that are served by keeping company records:

- Knowledge-base accumulation
- Support of strategic decision making
- Reinforcement of corporate culture
- Marketing
- Public relations

Given the importance of these needs for the proper functioning of a company, it should be easy to persuade CEOs to keep company records. However, in practise it may be very difficult to persuade the appropriate level of management of the advantages of keeping company records in good shape, and especially of establishing an archive for in-house purposes. The task becomes even more daunting when trying to persuade either the CEOs or the appropriate level of management to make an in-house archive available to the public.

For purposes of this discussion, we will not delve into the matter of in-house keeping of records versus outsourcing of company archives. This of course can be a significant issue, but it is not our focus. The problem discussed here is whether business archives are made publicly available, not where they are.

And there is a very good business reason for making company records available to the public – in due time, of course. We are not talking about making yesterday's decisions publicly available today. The public must wait say, 25 or 50 years, or whatever number of years the company decides. We are talking about records that no longer belong to the present, but that have become part of history.

The business reason for opening the archives to the public has to do with the image of the company. There is probably no better way for a company to establish an image of honesty and credibility than by opening its archives to the public. This is of great and immeasurable importance to the company. The importance of an honest company image becomes obvious if we – just for a moment – imagine the opposite: that a company has gained a reputation for dishonesty and fraudulence. The effects will surely be felt on the bottom line, although it is impossible to say exactly how much of the damage is caused by the dishonest reputation.

A company has much to gain by keeping an archive and making the historical records available to the public. It will establish a reputation of social responsibility and transparency by opening historical information to customers, collectors, documentary film makers, descendants of employees, students, historians and other public sectors with an interest in the company's past.

A SUBMISSION TO THE CORPORATIONS AND MARKETS ADVISORY COMMITTEE IN RESPONSE TO THE CORPORATE SOCIAL RESPONSIBILITY DISCUSSION PAPER

by

Corporate Law & Accountability Research Group
Department of Business Law and Taxation
Faculty of Business and Economics, Monash University

This submission was prepared by:

- Helen Anderson (Senior Lecturer)
- Paula Darvas (Lecturer)
- Anthony Forsyth (Senior Lecturer)
- Wayne Gumley (Senior Lecturer)
- Michelle Welsh (Senior Lecturer).

We incorporate by reference our earlier submission made to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility ('the PJC submission'). A copy of the PJC submission is attached.

This submission addresses some of the issues set out at section 3.4 of the CAMAC Corporate Social Responsibility Discussion Paper. Specifically this submission addresses the following questions:

- Should the Corporations Act be revised 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?
- Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?
- Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties?
- Should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

Should the Corporations Act be revised 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?

The Corporations Act should be revised to clarify the extent to which directors may consider the interests of employees, the environment, creditors, consumers, and other stakeholders in the normal course of company decision-making. The Corporations Act should be revised to clarify the circumstances under which directors may take into account the interests of other stakeholders where those interests conflict with the interests of shareholders and the shareholder profit maximisation objective.

This issue is addressed in the PJC Submission at paragraph (d).

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

The Corporations Act should be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. In addition the Corporations Act should be revised to require directors to prioritise stakeholder interests over those of shareholders in certain circumstances.

It is our submission that in order to genuinely protect non-shareholder constituencies, legislation would need to be passed to mandate directors to consider non-shareholder interests in situations where there is a conflict with the interests of shareholders and the shareholder profit maximisation objective. The issue of when such interests are to be given priority is problematic. Non-shareholder cohorts are most vulnerable when the company is in financial distress and the directors are desperately seeking to keep it afloat.

Accordingly, we recommend that the duty of directors under the *Corporations Act* to act in good faith in the best interests of the company should be amended to enable and, in certain circumstances, require directors to consider the interests of non-shareholder stakeholders. Stakeholder interests should be given priority in situations where there is a heightened risk that those interests will suffer adverse treatment. This heightened risk arises primarily when the company is encountering financial difficulty and may, or has, become insolvent.

This issue is addressed in the PJC Submission at paragraph (d).

Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties?

A pluralist approach to directors' duties should be adopted. In certain circumstances directors should be required to serve a wider range of interests in their corporate decision making, not subordinate to, or merely as a means of achieving shareholder well-being. There will be situations where shareholder interests will be required to be sacrificed in favour of the interests of other stakeholders.

This issue is addressed in the PJC submission at paragraph (d).

Should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

Companies are powerful and have the capacity to cause damage to the interests of others, such as employees, creditors, and victims of their torts, as well as the environment. Our submission is that this power gives rise to a responsibility to take care of those parties' interests. The public interest in regulating directors' actions by reference to increasingly accepted standards of corporate social responsibility outweighs the potential negative effects of such regulation

This issue is addressed in the PJC submission at paragraph (b).

A SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES
INQUIRY INTO CORPORATE RESPONSIBILITY

by

Staff Members of the Department of Business Law and Taxation (BLT)
Faculty of Business and Economics, Monash University:

Helen Anderson, Paula Darvas,
Anthony Forsyth, Wayne Gumley and Michelle Welsh

TABLE OF CONTENTS

a. The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.	**3**
b. the extent to which organisational decision makers should have regard for the interests of stakeholders other than shareholders, and the broader community.	**4**
(b)(1) What are the interests for which organisational decision makers should have regard, and why should they have regard for those interests?	**4**
(b)1.1 Employee interests	**4**
(b)1.2 Creditors	**5**
(b)1.3 Tort victims	**5**
(b)1.4 Environmental interests	**6**
(b)1.5 Theories of the Corporation and Corporate Responsibility	**8**
(b)1.5.1 Economic theories	**8**
(b)1.5.2 ‘Team production’ theory	**8**
(b)1.5.3 ‘Communitarian’ theory	**9**
(b)1.5.4 ‘Concession’ theory	**11**
(b)1.6 Further justifications for corporate responsibility	**12**
(b)(2) When should organisational decision makers have regard for non-shareholder interests?	**13**
(b)(3) Whose responsibility is it to have regard for non-shareholder interests?	**14**
(b)3.1 Should directors be made personally liable?	**14**
(b)3.2 Difficulties with imposing liability on directors	**15**
(b)3.3 Why regulation of directors’ decision-making is necessary	**16**
c. The extent to which the current legal framework governing directors duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders and the broader	**16**

community.	
(c)(1) The Position of Employees under Australian Corporate Law	**17**
(c)1.1 The Current Legal Position	**17**
(c)1.2 Recent Moves to Accommodate Employee Interests	**19**
(c)(2) The Position of the Environment under Australian Corporate Law	**22**
(c)2.1 The General Position	**22**
(c)2.2 Recent moves to Encourage Corporate Environmental Responsibility	**22**
(c)2.2.1 Mandatory environmental reporting - s 299(1)(f)	**22**
(c)2.2.2 Minority shareholder resolutions – s 249D	**23**
(c)2.2.3 Product Disclosure Statements – s 1013DA	**23**
(c)2.3 The effectiveness of specific environmental regulation	**24**
d. Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders, other than shareholders, and the broader community.	**27**
(d)(1) Introduction	**27**
(d)(2) Recommendations for new directors' duties to recognise stakeholder interests in company decision making	**29**
(d)2.1 A *permissive* aspect having general application	**29**
(d)2.2 A *mandatory* aspect having specific application	**30**
(d)2.3 Two further *mandatory* aspects to specifically address employee interests	**30**
(d)2.4 Four further *mandatory* duties to specifically address the interests of the broader community in achieving ecologically sustainable development and protection of the natural environment	**31**
(d)(3) Enforcement mechanisms	**32**
(d)3.1 Civil penalty provisions	**32**
(d)3.2 What changes would need to be made to the regime?	**34**
(d)3.3 Standing for environmental breaches	**35**
(d)3.4 Strategic regulation theory	**35**
g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.	**38**
(g)(1) Recent legal changes in the United States	**38**
(g)(2) Current and proposed legislation in the United Kingdom	**38**
ABOUT THE CONTRIBUTORS	**40**

A SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES INQUIRY INTO CORPORATE RESPONSIBILITY

by

Staff Members of the Department of Business Law and Taxation (BLT)
Faculty of Business and Economics, Monash University

This submission was prepared by:

- Helen Anderson (Senior Lecturer)
- Paula Darvas (Lecturer)
- Anthony Forsyth (Senior Lecturer)
- Wayne Gumley (Senior Lecturer)
- Michelle Welsh (Lecturer).

Based on the interests of these contributors, the submission focuses on the following main areas:

- theories of corporate responsibility
- the need to increase the recognition of employee and environmental concerns in the corporate law framework
- enforcement mechanisms.

We address below relevant parts of the Committee's Terms of Reference for the Inquiry.

a. The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

To a limited extent, corporations in Australia do have regard to the interests of stakeholders other than shareholders, due to a range of influences including:

- Specific legal obligations imposed upon the company by various legislative schemes which protect the interests of a range of stakeholders, including employment laws, occupational health and safety laws, insolvency laws, trade practices and environmental laws.
- General fiduciary duties imposed upon company directors requiring them to act in the interest of the corporation (and its shareholders). For instance, these duties may require adoption of prudent risk management strategies to avoid or minimise the potential risk of liability to third parties arising from legal proceedings based on common law principles such as negligence, nuisance or defamation.
- Voluntary strategies which seek to protect the interests of stakeholders as a matter of good corporate citizenship. These strategies are often used to enhance the 'brand name' or reputation of the corporation in the belief this will enhance profitability.

However we would argue that there have been many well publicised instances where stakeholder (and shareholder) interests have been subverted or ignored by corporate managers, indicating that the present legal framework is inadequate to ensure the protection of non-shareholder interests (some examples are provided in other parts of this submission).

b. the extent to which organisational decision makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

This issue raises a series of subsidiary questions.

(b)(1) What are the interests for which organisational decision makers should have regard, and why should they have regard for those interests?

There is a growing acknowledgment – by corporations themselves and the broader community - of the impact of corporate activity on other stakeholders, such as employees, creditors, victims of their torts, as well as the environment. This is reflected in the increased focus on corporate governance in Australian law in relation to large publicly listed companies, and the terms ‘Corporate Social Responsibility’ (CSR) and ‘Corporate Citizenship’. However, these are poorly defined concepts. They are generally understood to convey a sense that companies are powerful and have the capacity to hurt the interests of others, such as employees, creditors, and victims of their torts, as well as the environment. Our submission is that this gives rise to a responsibility to take care of those parties’ interests.

(b)1.1 Employee interests

In recent years, the high-profile collapses of companies like Ansett and One.Tel, and the James Hardie episode, have highlighted the vulnerability of employees in Australia’s current corporate law framework. In these and many other cases of corporate failures and restructures, employees’ interests have been overlooked or consciously bypassed. The political fallout from these events has led to some changes to corporations legislation, and the adoption of arrangements such as the General Employee Entitlements and Redundancy Scheme. However, these measures do not go far enough. Despite their enormous investment of “human capital” in the firms for which they work, employees are still largely regarded as “outsiders” by company law – with none of the information rights and measures to protect their interests enjoyed by “insiders”, such as shareholders and secured creditors.[1]

[1] The ‘insider/outsider’ terminology is borrowed from B Bercusson, ‘Workers, Corporate Enterprise and the Law’ in R Lewis (ed), *Labour Law in Britain* (1986) 139; see further Part (c) of this submission below.

(b)1.2 Creditors

Creditors, like employees, are also vulnerable to the risk of non-payment when a company becomes insolvent. While some creditors hold security or have had the ability to price-protect against the risk of non-payment or to diversify away their risk, other have not. These are the small trade creditors who lack information about the risks to which they are exposed or who are unable because of their lack of bargaining power to charge a premium to compensate for that risk.

(b)1.3 Tort victims

Tort creditors are particularly susceptible to the absence of any legal obligations of corporate social responsibility, because they lack the ability to self-protect ex ante or any rights of recovery ex post under the *Corporations Act*.[2] This is a particular problem when a holding company has deliberately incorporated an undercapitalised subsidiary to minimise the loss of shareholder funds. As the James Hardie case graphically illustrated, the "separate entity" principle stands in the way of tort victims seeking to recover compensation within corporate groups, in that case necessitated by the underfunding of the Medical Research and Compensation Fund that had been established for this purpose. The Report of the Special Commission of Inquiry into James Hardie identified "significant deficiencies in Australian corporate law", and raised "the question of whether existing laws concerning the operation of limited liability or the "corporate veil" within corporate groups adequately reflect contemporary public expectations and standards."[3]

Tort victims may also be disadvantaged by the adversarial nature of the judicial system in pursuing claims against powerful corporations. This was well demonstrated in the case of now deceased lung cancer victim, Mrs Rolah McCabe, whose claim against British American Tobacco was severely hindered by the destruction of relevant information by the company.[4] This case highlights the need for some form of moral or ethical charter to guide decision-making within corporations.

This vulnerability is exacerbated by the attitude of courts to claims against directors when they commit torts whilst acting on behalf of the company. First, the legal position is confusing with at least four recognised tests to ascertain the circumstances

[2] Injury compensation enjoys a degree of priority for payment in a liquidation under s556(1)(f) of the *Corporations Act 2001* (Cth) but it ranks behind the wages and superannuation entitlements of employees. Since these and other higher ranking categories of priority must be paid in full before lower categories are considered, there is a significant risk that injury compensation claimants will not be fully compensated as a result of this priority.

[3] David Jackson, The Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation, 2004, *Annexure T The Concept of Limited Liability – Existing Law and Rationale,*< http://www.cabinet.nsw.gov.au/hardie/Volume1.pdf >.

[4] The history of this case is set out at the website of the Plaintiff's solicitors, Slater and Gordon; see http://www.slatergordon.com.au/classactions/tobacco.htm. Ultimately, an application by the plaintiff's estate for special leave to appeal to the High Court was unsuccessful. See *Cowell v British American Tobacco Australia Services Ltd* [2003] HCATrans 384 (3 October 2003).

where personal liability can be imposed on directors.[5] Secondly, some courts use the limited liability doctrine to incorrectly deny a tort victim's claim against a director in their capacity as a director, whereas its proper use is to protect shareholders.[6] Thirdly, the organic theory and the separate legal entity of the company is sometimes invoked to protect directors,[7] even though its proper role[8] is to attribute the mental state of the director to the company for the purpose of finding the company liable, and not for the purpose of removing that liability from the perpetrator of the action on which the liability is based.[9]

(b)1.4 Environmental interests

The natural environment is particularly vulnerable to corporate abuse due to a combination of rapid growth in the global economy, recent microeconomic reforms and deregulation of commercial activities. The rapid growth of human population and our western consumer based lifestyle following the industrial revolution has led to human domination of the Earth's ecosystems[10], including a crisis in resource

[5] In *G M (North Melbourne) v Young Kelly* (1986) 7 IPR 149, directors' liability for their tortious actions on behalf of their companies was described as a 'complex and burgeoning field of the law' at 158. In *Root Quality Pty Ltd v Root Control Technologies Pty Ltd*, Finkelstein J called it a 'confusing picture on an issue that has persistently vexed the common law' (2000) 177 ALR 231, [115]. See also *Johnson Matthey (Aust) Pty Ltd v Dascorp Pty Ltd* [2003] VSC 291, [111]; John Farrar, 'The Personal Liability of Directors for Corporate Torts' (1997) 9 Bond Law Review 102; Helen Anderson, 'The Theory of the Corporation and Its Relevance to Directors' Tortious Liability to Creditors' (2004) 16 *Australian Journal of Corporate Law* 73.

[6] For example, Cooke P noted in *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517, 524 that 'I commit myself to the opinion that, when he formed his company, Mr Ivory made it plain to all the world that limited liability was intended. Possibly the plaintiffs gave little thought to that in entering into the consultancy contract but such a limitation is a common fact of business …'.

[7] For example, Hardie Boys J in *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517, 526 commented that '[t]o make a director liable for his personal negligence does not in my opinion run counter to the purposes and effect of incorporation. … What does run counter to the purposes and effect of incorporation is a failure to recognise the two capacities in which directors may act; that in appropriate circumstances they are to be identified with the company itself, so that their acts are in truth the company's acts. Indeed I consider that the nature of corporate personality requires that this identification normally be the basic premise and that clear evidence be needed to displace it with a finding that a director is acting not as the company but as the company's agent or servant in a way that renders him personally liable.'[7]

[8] *Meridian Global Funds Management Asia Ltd v the Securities Commission* [1995] 2 AC 500, 505 and *Smorgon v Australia and New Zealand Banking Group Ltd* (1976) 134 CLR 475.

[9] See further Neil Campbell and John Armour, 'Demystifying the Civil Liability of Corporate Agents' (2003) 62 *Cambridge Law Journal* 290; Jennifer Payne, 'The Attribution of Tortious Liability Between Director and Company' [1998] *Journal of Business Law* 153; David Wishart, 'Anthropomorphism Rampant: Rounding up Executive Directors' Liability' [1993] *New Zealand Law Journal* 175; John Farrar, 'Frankenstein Incorporated or Fools' Parliament? Revisiting the Concept of the Corporation in Corporate Governance' (1998) 10 *Bond Law Review* 142.

[10] P M Vitousek, H A Mooney, J Lubchenco and J M Melillo, 'Human Domination of Earth's Ecosystems' (1997) *Science* 494. Estimates of the fraction of land transformed or degraded by humanity fall in the range of 39-50%. The rates of species extinction are now of the order of 100 to 1000 times those before humanity's dominance of the Earth, eg one quarter of the Earth's bird species have been driven to extinction in the last two millenia.

consumption[11], and unprecedented water shortages, deforestation and species extinction rates along with the prospect of irreversible climate change[12]. It is clear that the current framework of international agreements and national laws to protect the environment is failing.

The traditional model of environmental law has been a ‘command and control’ approach based on strict government regulation of industrial pollution and government ownership of natural resources. This traditional approach has become less effective following widespread micro-economic reforms that have fostered globalisation, deregulation and privatisation of state-owned enterprises. These reforms have greatly diminished government influence over the use of natural resources. The traditional model is also less effective due to a fundamental change in the nature of environmental problems, with concerns about local industrial pollution now overtaken by global concerns about excessive resource consumption, exploitation of developing countries, climate change and biodiversity loss. The role of the courts in protecting the natural environment is equally problematic, with rules of standing and inequality in financial resources between local residents and large corporations making litigation a very difficult option for stakeholders.

One important step in the transition to sustainable development is reform of decision making processes, as recognised by the United Nations Environment Program in *Agenda 21*:[13]

> 8.3. The overall objective is to improve or restructure the decision-making process so that consideration of socio-economic and environmental issues is fully integrated and a broader range of public participation assured.

In this context it is important to distinguish between public or government decisions and private or corporate decisions. At the government level there have been several *mandatory* processes introduced to assist the integration of environmental outcomes in decision-making. These include the obligation to have regard to principles of sustainable development in State based pollution and planning laws, and in Federal environmental impact assessment laws.[14] Another important feature of government decision making processes is that public participation and standing to review decisions is well supported by a range of administrative law remedies.[15] By contrast, processes for review of corporate decision making are far more limited. This relative

[11] World Wildlife Fund, *Living Planet Report 2004*. This Report indicates that our ‘ecological footprint’ (which measures human resource consumption) is currently 20% greater than the Earth’s biological capacity to replace those resources. Any business with a similar 20% shortfall of costs over revenue would soon be wound up.

[12] Intergovernmental Panel on Climate Change, *Third Assessment Report of Working Group 1, Summary for Policy Makers* (2001).

[13] Agenda 21 is the charter for action formulated by the parties to the Rio Earth Summit. See United Nations (1992) *Agenda 21*; United Nations Conference on Environment & Development Rio de Janeiro, Brazil, 3 to 14 June 1992.

[14] Eg. ss 1A-1L *Environment Protection Act* 1970 (Vic), ss 4 *Planning and Environment Act* 1987 (Vic), and ss 3, 3A *Environment Protection and Biodiversity Conservation Act* 1999 (Cth).

[15] *Administrative Law Act* 1978 (Vic), *Administrative Decisions (Judicial Review) Act* 1977 (Cth), *Freedom of Information Act* 1989 (Cth).

lack of accountability does not sit well with the recent wave of microeconomic reforms, which have diminished government involvement and placed many corporations in a quasi-governmental role with respect to environmental protection.

This lack of environmental accountability is particularly dangerous in industries which are heavy users of natural resources, such as agriculture (water, land), paper production (water, forests), electricity generation and transport (fossil fuels, greenhouse gases). In these industries, government decision-making still has an important role, but quite often it merely sets broad guidelines for corporate activities (eg. pollution standards) whilst corporate decision-making determines the real extent of environmental damage (or protection). In effect, corporations are increasingly the *de facto* guardians of the public interest in the natural environment, and thus reform of corporations law is necessary to ensure that corporations discharge this responsibility in the best interest of the community.

However, any attempt to impose a regime of corporate social and environmental responsibility needs to be reconciled with the traditional responsibilities that companies have to their shareholders and that directors have to their companies.

(b)1.5 Theories of the Corporation and Corporate Responsibility

(b)1.5.1 Economic theories

Traditionally, directors have been confined in their actions by the shareholder wealth maximisation imperative. Companies have been seen by economic theorists as a nexus of contracts, rather than an entity in their own right.[16] The contracts in question are with suppliers of inputs, employees, and customers of outputs, and to maintain these contracts, the company needs to be concerned with the interests of these constituencies. To that extent, companies and directors choose to have regard to their interests.

(b)1.5.2 'Team production' theory

More recently developed law and economics theories look more explicitly at the contributions to the company made by non-shareholder constituencies. Team production theory[17] recognises the power of the board, but it is based on the notion that two or more individuals must combine their valuable resources to produce a single output. Directors, rather than acting solely in the shareholders' interests, act for

[16] William Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) 74 *Cornell Law Review* 407, 420. The word 'contracts' is not meant literally in this context. Instead it refers to the various relationships between the parties. Companies have relationships with the eventual consumers of their products despite a lack of privity of contract between them. Companies have relationships with the community at large, for example in their environmental responsibilities. Christopher Riley, 'Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 *Modern Law Review* 782, 785-6.

[17] Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

all members of the corporate team which contribute to this output.[18] The purpose of the theory is to identify a unity of interest between team members in order to overcome the agency costs which arise when their interests diverge. Agency costs are one of the transaction costs a company incurs in making a bargain.[19]

Under team production theory, while the participants know that incorporation involves giving up control over their contributions to the firm, exposing them to the risk of opportunism or shirking by others, the board of directors as a 'mediating hierarchy' resolves these clashes.[20] Directors are given the task of balancing the competing interests of the team 'in a fashion that keeps everyone happy enough that the productive coalition stays together.'[21]

(b)1.5.3 'Communitarian' theory

Another recent approach which looks at the position of non-shareholder constituencies is the communitarian, or progressive corporate law, view. This looks at the place of the company in the community and argues that various corporate stakeholders are vulnerable to abuse at the hands of those who control corporate power. It is by no means a unified school of thought: Bainbridge noted that '[t]hese scholars are far more united by what they oppose … than by what they support'.[22]

As early as 1932, commentators were looking beyond the interests of shareholders to the corporation's wider impact on society. Berle and Means argued that '[n]either the claims of ownership nor those of control can stand against the paramount interests of

[18] 'The interests of the corporation … can be understood as a joint welfare function of all the individuals who make firm-specific investments and agree to participate in the extracontractual, internal mediation process within the firm. For most public corporations, these are primarily executives, rank-and-file employees, and equity investors, but in particular cases the corporate team may also include other stakeholders such as creditors, or even the local community if the firm has strong geographic ties.' Ibid 288.

[19] In the corporate setting, the term 'agent' is used broadly to capture the position wherever there is an arrangement where the principal's welfare depends on what the agent does. According to Jensen and Meckling, 'there is good reason to believe that the agent will not always act in the best interests of the principal.' Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 308. This behaviour, where a party's actions are for their own benefit, is known as 'shirking'. This area of study is also known as transaction cost economics. See further Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386; Armen Alchian and Harold Demsetz, 'Production, Information Costs and Economic Organisation' (1972) 62 *American Economic Review* 777; Oliver Hart, 'An Economist's Perspective on the Theory of the Firm' (1989) 89 *Columbia Law Review* 1757, 1760-3.

[20] ' … shareholders, employees, and perhaps other stakeholders such as creditors or the local community … enter into this mutual agreement in an effort to reduce wasteful shirking and rent seeking by relegating to the internal hierarchy the right to determine the division of duties and resources in the joint enterprise'. Blair and Stout, above n 17, 278.

[21] Ibid 281.

[22] Stephen Bainbridge, 'Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship' (1997) 82 *Cornell Law Review* 856, 857. Bainbridge also took issue with the use of the word 'progressive' which he believed is 'simply a code word used by the political left to take advantage of the positive connotations most Americans associate with the idea of progress'. Ibid.

the community … It remains only for the claims of the community to be put forward with clarity and force.' [23]

As with the team production model, the communitarian considers the wider constituency of a company. Its rhetoric is of directors' behavioural change,[24] from focusing on the traditional wealth maximisation objective to furthering the long term viability of the enterprise which relies on the co-operation of all corporate stakeholders.[25] This requires a consideration of ethics and fairness, which, progressives maintain, is in the overall best interests of the company because it fosters trust and reduces risk and the costs associated with it.[26] While directors are allowed to favour one cohort of corporate stakeholders over another, this is only permissible where this is in the long term interests of the company. Konstant remarked that this view 'provides a new and more inclusive paradigm of corporate governance in which stakeholder voice and loyalty are crucial.'[27]

The mechanisms by which progressives believe this paradigm will be achieved are less clear. Williams asserted that disclosure and transparency are key determinants of directors' actions, and that scrutiny by corporate stakeholders will foster beneficial norms of behaviour.[28] Greenfield contended that if corporate actions are perceived to be procedurally fair, the behaviour of others improves, to the benefit of all stakeholders.[29] Konstant recommended the appointment of an independent board, which 'can check opportunistic abuses by powerful inside senior managers and which can give voice and procedural fairness to all constituents.'[30] An independent board is also desirable because it lacks any personal financial incentive to benefit its members from its actions, and risks reputational damage from breaches of the law.

[23] Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (revised ed, 1968) 312.

[24] Peter Konstant, 'Team Production and the Progressive Corporate Law Agenda' (2002) 35 *UC Davis Law Review* 667, 676. 'Serious application of TPM [the team production model of Blair and Stout] offers at least the possibility that public corporations can achieve some meaningful increase in fairness for all corporate constituents. Such fairness can be accomplished without changing legal rules, but by encouraging directors and all corporate constituents to act in accordance with TPM under the existing law.'

[25] Ibid 669.

[26] Ibid 671.

[27] Ibid 674. Konstant rejected suggestions that the communitarian view is Utopian. He maintained that 'the currently dominant academic model of corporate law is such a caricature of selfishness that the ameliorative mechanisms that corporate communitarians propose can seem real, grounded, and morally refreshing' at 676.

[28] Cynthia Williams, 'Corporate Social Responsibility in an Era of Economic Globalization' (2002) 35 *UC Davis Law Review* 705, 711-17.

[29] Kent Greenfield, 'Using Behavioural Economics to Show the Power and Efficiency of Corporate Law as a Regulatory Tool' (2002) 35 *UC Davis Law Review* 581, 642.

[30] Konstant, above n 24, 683.

It may be argued that because communitarianism is ultimately in the best interests of the corporation, the implementation of these mechanisms requires no change to the existing law,[31] and thus some communitarians regard the theory as both positively descriptive and normatively useful. Nonetheless, there are serious practical obstacles in implementing communitarianism. The outlook it espouses is of more relevance to the large public company than the far more typical, closely held proprietary company. As Millon noted, any action by the board which deviates from the traditional wealth maximisation objective exposes the board to dismissal or the company to a hostile takeover, as disenchanted shareholders sell their shares and look for better investments.[32] Shareholders are legally entitled to vote in such a way that enhances their own financial position, even if that causes harm to non-shareholders. [33]

It may also be argued that the theory provides no guidance to decide between competing claims; rather it seems to hope that everyone who is fairly treated and 'heard' by the board will accept 'give and take' without making the board, as referee, decide who should win and who should lose. Moreover, it does not assist in determining the winner where two communitarian claims are competing. Communitarianism may support the imposition of liability on directors to consider the claims of creditors, employees or others, but if satisfying those claims makes a director risk averse, that could have economically detrimental effects on the directors' behaviour. In other words, is it better to ensure that a non-shareholder constituencies have an entitlement to be compensated by the director for failing to pay due regard to their interests, or that the director is more willing to take risks and expand the business, creating jobs and wealth for the community as a whole? However, it needs to be recognised that whilst taking financial risks may be a normal part of business, public policy has now reached a point where it is simply unacceptable for corporations to take risks with the environment or citizen welfare.

The focus in all of these theories of the corporation is on achieving the best for the company and its shareholders, whether that is done by concentrating on shareholders exclusively or by looking at wider stakeholder groups. Another perspective is to look at the company's place in society, regardless of its role in maximising shareholder wealth.

(b)1.5.4 'Concession' theory

Indeed this is the way that some 'progressive corporate law' scholars understand communitarianism. It is sometimes also known as the 'concession theory of the firm'.

[31] Section 181(1) of the *Corporations Act* states that '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.'

[32] David Millon, 'New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law' (2000) 86 *Virginia Law Review* 1001, 1024-30.

[33] David Millon, 'Communitarians, Contractarians, and the Crisis in Corporate Law' (1993) 50 *Washington and Lee Law Review* 1373 1384 commented that '[t]he claim that shareholders should continue to enjoy a property right to harm non-shareholders incidentally to their pursuit of profit maximisation seems at times to rest on nothing more than a reflexive commitment to the status quo.'

It sees incorporation as a privilege bestowed by the government, thereby justifying government interference. Cohen explained:

> Under this understanding, limited liability entities have a responsibility to operate in the public interest. Under the concession/communitarian view, the 'corporateness' of the artificial entity should be disregarded when the entity is being operated in a manner which runs counter to the spirit of the grant of privilege, ie, when the public wealth is damaged, rather than enhanced, by the operation of the corporation.[34]

Unlike the other theories outlined above, this permissive philosophy allows for the consideration of the interests of non-shareholder constituencies where they actually conflict with the wealth maximisation objective. It is then a matter for legislative and political process to decide exactly how far the corporation will be responsible for matters beyond the generation of profits for its members.

It also goes some way to answering the question 'why should the company have regard for the interests of non-shareholder stakeholders and the broader community'. Two factors are important here – first, the power of the corporation, especially large corporations and secondly, the privilege that the veil of incorporation brings.

(b)1.6 Further justifications for corporate responsibility

It has frequently been observed that the economic activity of some multinational corporations is larger than the GDP of small countries. There is a perception that this size brings responsibilities, similar to those owed by governments. These companies can have significant impacts on the economy, for example if they move production offshore with resulting job losses, or on the environment. The power of the companies and the vulnerability of the community to these actions gives rise to a sense of fiduciary duty, such as is owed by trustees to beneficiaries or directors to their companies. There is also an element of market failure here, due to an absence of effective competition, which justifies government intervention.

But should McDonald's, for example, be obliged to buy Australian potatoes for their chips rather than the cheaper New Zealand ones to protect the livelihoods of Australian growers? If the cost of the product is forced to rise because Australian potatoes are used, and consumers bear this cost, which of the non-shareholder interests should be heeded? And what if the price rise is not passed on and dividends for Australian shareholders drop – who in society is deemed most worthy of the company's 'corporate social responsibility'? These questions are ultimately political in nature, and the reality for modern corporations is that they must somehow be addressed. The concession theory suggests that a corporation the size of McDonalds should consider the impact of its actions on the broader community within which it operates. After all, that community provides the corporation with a market and a licence to make profits as well as a range of essential requirements including raw materials, staff, infrastructure and environmental services. In return, it is reasonable to

[34] David Cohen, 'Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate rules for Piercing the Veil. Fiduciary Responsibility and Securities Regulation for the Limited Liability Company' (1998) 51 *Oklahoma Law Review* 427, 444. See also Stephen Bottomley, 'Taking Corporations Seriously: Some Considerations for Corporate Regulation' (1990) 19 *Federal Law Review* 203, 206.

expect that the corporation will consider the interests of that community when it makes business decisions that may be detrimental to that community. A simplistic economic approach based purely on cost minimisation is not a sufficient process for this purpose.

Under concession theory, the idea of the vulnerability of non-shareholders and the community is compounded by the limited liability of shareholders and the separate legal entity of the company. This produces a veil of incorporation which protects the managers and owners of small and large companies alike from the consequences of their actions. This point will be explored further below under the heading of whose responsibility it is to look after non-shareholder constituents.

(b)(2) When should organisational decision makers have regard for non-shareholder interests?

Under team production theory, keeping the parties happy during the solvency of the company is relatively easy. By definition, creditors and employees are being paid; environmental agencies are enforcing the law against errant companies and directors; customers are being looked after because otherwise they may take their business elsewhere.

However, the chief problem with this theory occurs when the company nears insolvency: just when the creditors and employees need the company and its directors to take care of them, their interests deviate from those of shareholders. The natural environment is also at risk at this time as an insolvent enterprise may choose to relax its standards on pollution and waste management. Since the directors' established fiduciary duty is to the company, they may not be permitted, let alone mandated, to consider others' interests at that time. The board of directors, in whom the creditors and employees are expected to repose their trust as a mediating hierarchy, is, after all, voted for exclusively by the shareholders and not by other participants in the corporation.

Therefore, in any consideration of whether organisational decision makers should have regard to the interests of stakeholders other than shareholders and the broader community, the time when this ought to take place needs to be considered. Should it be their responsibility only when the company is a going concern, or ought it to continue when the company is in financial distress? The point here is simple – if it is difficult for managers to take into account the concerns of multiple parties when the company is viable and successful, how much harder is it to consider those parties when the company faces extinction? Yet it is often precisely at this time that non-shareholder interests are most vulnerable to the decisions of the company's board.

Scott commented:

> As long as the debtor's business prospects remain good, a strong reputational incentive deters misbehaviour. But once the business environment deteriorates, the [director] is increasingly influenced by a 'high-roller' strategy. The poorer the prospects for a profitable conclusion to

> the venture, the less the entrepreneur has to risk and the more he stands to gain from imprudent or wrongful conduct. [35]

The problem is particularly acute for directors of small companies, who do not always have reputational incentives. Keay noted that 'it has become axiomatic that this risk-taking will take place, particularly where the directors are also the owners in the context of closed corporations.'[36] However, he remarked on the importance of wanting 'to avoid, particularly where there is a conflict of interests between corporate stakeholders, ending up with a vague obligation imposed on directors that has little content and provides insubstantial guidance.'[37] This leads to the issue of whose responsibility it is to consider the interests of non-shareholder constituencies – the company's or the directors and managers?

(b)(3) Whose responsibility is it to have regard for non-shareholder interests?

(b)3.1 Should directors be made personally liable?

Imposing personal responsibility on directors for behaviour that may damage the interests of stakeholders other than shareholders, deals with the moral hazard occasioned by the separate legal entity principle. It encourages directors to either obey the law or to protect themselves against liability by some other means. This may include taking more care to maintain adequate capitalisation of the company, so that claimants sue the solvent company rather than the directors themselves. Alternatively, they may seek insurance on behalf of the company or themselves.

Imposing liability or punishment on the company alone may be insufficient especially where an undercapitalised company owned by a sole shareholder will be happily abandoned to liquidation.[38] Finch noted, with reference to ensuring compensation for tort creditors:

> Personal liability may leave risk evaluation and spreading to those individuals who are the best acquirers of information concerning corporate risks, levels of capitalisation, internal control systems and insurance. It thus offers firms a flexibility of response that may be preferable to externally-imposed rules on minimum insurance or adequate capitalisation. Making the director liable thus protects against legislative over-or-under provision for tort risks, and it permits managers to select the optimal strategy for covering risk from among insurance, self-insurance or risk-reduction though the control of the firm activities.[39]

[35] Robert Scott, 'A Relational Theory of Default Rules for Commercial Contracts' (1990) 19 *Journal of Legal Studies* 597, 624.

[36] Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 *Modern Law Review* 665, 669 (footnotes omitted).

[37] Ibid 671.

[38] Vanessa Finch, 'Personal Accountability and Corporate Control: The Role of Directors and Officers' Liability Insurance' (1994) 57 *Modern Law Review* 880, 881-2.

[39] Ibid 883 (footnotes omitted).

(b)3.2 Difficulties with imposing liability on directors

However, a number of difficulties arise from the imposition of personal liability on directors. Experienced, well qualified business people may be reluctant to take up directorships,[40] thus depriving companies of a valuable resource.[41] Moreover, imposing liability on non-executive directors may be detrimental to a large company's ability to attract such directors. Finch commented:

> The outsider faces severe obstacles in monitoring board activity and the prospect of being held liable for failing in such monitoring functions may prove an excessive deterrent to non-executive direction, notably when the economic benefits of non-executive direction are seen to be dwarfed by potential liabilities for damages.
>
> Alternatively, companies when selecting outside directors may seek to avoid such problems by choosing directors who are either non-risk averse or uncritical of risk taking. An incentive to select on such a basis would run counter to notions of the outside director as a check on corporate folly.[42]

Finch also observed that the imposition of liability may lead to inappropriate delegation to subordinates or outside consultants to avoid directors bearing personal responsibility.[43] Another difficulty is its cost, as the directors may demand compensation for being exposed to actions for breach of duties to stakeholders. Like other employees, directors generally are unable to minimise their risk by diversification. As the Easterbrook and Fischel pointed out:

> The problem with managerial liability is that risk shifting may not work perfectly. … a legal rule of managerial liability creates risks for a group with a comparative disadvantage in bearing that risk. This inefficiency leads to both an increase in the competitive wage for managers and a shift away from risky activities. And there is no guarantee that the social costs of this shift away from risky activities will not exceed the social costs of the excessively risky activities in the absence of managerial liability.[44]

[40] The American experience following *Smith v Van Gorkom,* 488 A 2d 858 (Del, 1985) is relevant here. In *Smith*, the Delaware Supreme Court held directors liable for gross negligence and thus the directors were unable to avail themselves of the protection of the business judgment rule. 'The corporate bar responded to the decision with horror…. Stockholders' suits against directors increased at a dramatic rate. With director and officer (D&O) liability insurance premiums increasing to levels that many companies could not afford, a large number of board members in the mid –1980s resigned rather than risk exposure to liability, as their companies "went bare". Even some directors who had insurance resigned because they had too many exclusions in their policies or had inadequate protection.' Ramesh KS Rao, David Sokolow and Derek White, 'Fiduciary Duty a la Lyonnais: An Economic Perspective on Corporate Governance in a Financially Distressed Firm' (1996) 22 *Journal of Corporation Law* 53, 58-9. (footnotes omitted)

[41] Nonetheless the fact is that most directors of closely held companies are also their major shareholders and thus will remain committed to the survival of the company even if this involves exposure to potential personal liability.

[42] Finch, above n 38, 885.

[43] Ibid 884-5.

[44] Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (1991) 50, 62.

As Easterbrook and Fischel note here, the fear of liability may make directors overly cautious.[45] This risk averse behaviour[46] on behalf of directors could be detrimental to the achievement of the company's profit and wealth maximization objectives although Keay reasoned that the additional care taken by directors under conditions of potential liability is in fact beneficial to the shareholders.[47] He contended:

> The argument that monitoring activity is costly and reduces efficiency masks the fact that monitoring is a necessary element of responsible corporate governance and a natural part of directors' functions, whether or not a duty to creditors exists … Rather than inhibiting efficiency, it might well lead to improvements that could be made in the company's procedures and profit-making processes …[48]

(b)3.3 Why regulation of directors' decision-making is necessary

Overall, however, as noted above, certain cohorts of non-shareholder stakeholder are particularly vulnerable to the risk of improper behaviour by corporate decision makers either during the solvency of the company or in its decline.

For these reasons, in our view the public interest in regulating directors' actions by reference to increasingly accepted standards of corporate social responsibility outweighs the potential negative effects of such regulation. Our recommendations for the form of that regulation are discussed in Part (d) below.

c. The extent to which the current legal framework governing directors duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders and the broader community.

This issue has already been explored in Part (b) of this submission. Australia has traditionally adhered very closely to a shareholder-centred model of corporate law.[49] Accordingly, the current legal framework provides companies and those who run them with very limited capacity to have regard for employee, environmental, and

[45] Coase argued that it is wrong to simply impose restraints upon director behaviour without weighing up the total cost of that intervention. Ronald Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1, 2. See also Jonathan Lipson, 'Directors Duties to Creditors: Power Imbalance and the Financially Distressed Corporation' (2003) 50 *UCLA Law Review* 1189, 1244.

[46] Eugene Fama and Michael Jensen, 'Agency Problems and Residual Claims' (1983) 26 *Journal of Law and Economics* 327, 327.

[47] For example, Modigliani and Miller contended that while the recognition of a duty to creditors causes costs to the company, directors and shareholders, the costs are offset by a correlative reduction in the cost of the credit, so that the position of the parties remains unchanged, in a state of economic equilibrium. Franco Modigliani and Merton Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 48 *American Economic Review* 261, 267-70.

[48] Keay, above n 36, 686.

[49] See eg Jennifer Hill, 'Public Beginnings, Private Ends – Should Corporate Law Privilege the Interests of Shareholders?' (1998) 9 *Australian Journal of Corporate Law* 21.

other non-shareholder interests – and in several important ways, actually discourages them from doing so. This part of the submission considers, in closer detail, how the traditional shareholder-centred paradigm of Australian corporate law has impacted upon two particular categories of non-shareholder interests, being employees and the environment.

(c)(1) The Position of Employees under Australian Corporate Law

(c)1.1 The Current Legal Position

The basic legal position is quite straightforward: the duty of directors to act in good faith and in the best interests of the company (at common law and under section 181 of the *Corporations Act*) requires directors to treat *shareholders'* interests as paramount. The interests of employees, or other stakeholders, *can* be considered in performing these duties – but only where this would also be in the company's (ie the shareholders') interests. Employee concerns cannot be placed ahead of those of shareholders. For example, a company could not make redundancy payments to employees in the context of a business closure, where this would run down the funds available for distribution to shareholders. Not even the company's interest in maintaining harmonious industrial relations would warrant directors pursuing such a course of action.[50]

Case law requires directors to consider *creditors'* interests when a company is insolvent or facing insolvency.[51] However, the cases stop short of establishing a *duty* that is enforceable at the instance of creditors;[52] only the company's liquidator or the Australian Securities and Investments Commission (ASIC) can bring an action for compensation or the recovery of company funds to return to creditors. As Symes has indicated, these developments do not provide much comfort to employees in insolvency situations. He noted that '[f]rom these cases, it is not possible to state that a duty to creditors upon insolvency means that they should take "care" of employees …' albeit that employees 'are creditors (statutory priority creditors, in fact) for their unpaid salary and other entitlements.'[53]

When companies become insolvent, employees not only lose their jobs. They also have to line up with other creditors for recovery of their unpaid wages and other employment entitlements. Workers take their place in the queue behind secured creditors (such as financiers), although they have the right to priority treatment over

[50] *Parke v Daily News Ltd* [1962] Ch 927; see also *Hutton v West Cork Railway Company* (1883) 23 Ch D 654.

[51] *Walker v Wimborne* (1976) 137 CLR 1*; Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722. The 'uncommercial transactions' provisions of the *Corporations Act* (section 588FB, 588FC, etc) operate as a form of statutory duty to protect creditors' interests.

[52] *Spies v R* (2000) 18 ACLC 727.

[53] Christopher Symes, 'A New Statutory Directors' Duty for Australia – A "Duty" to be Concerned about Employee Entitlements in the Insolvent Corporation' (2003) 12 *International Insolvency Review* 133, 137.

other unsecured creditors.[54] Frequently, however, there are no assets remaining to meet employee claims once the debts of secured creditors have been fully or partly satisfied.[55] We consider that employees are more then mere creditors, so that regulation should be put into place that reduces the "increased opportunities for business strategies that shift risk and insecurity onto workers"[56]

Employees are also comparatively disadvantaged in their capacity to *avoid* the adverse consequences of insolvency. Directors, shareholders, banks and other secured creditors are all privy (to varying degrees) to information that enables them to see the warning signs of corporate failure and act to protect their interests.[57] For example, corporate financiers have a range of devices at their disposal to secure their debts, such as mortgages, fixed and floating charges, pledges and liens.[58] Usually, these legal instruments also provide secured lenders with a vital source of information about the company's financial performance, through contractual provisions imposing reporting obligations on the borrower and allowing the lender to appoint accountants to look into the company's affairs when concerns arise.[59] The use of 'quasi-securities' of this nature not only bolsters the information rights of secured lenders, it can also obscure the company's true position for other creditors (including employees) by creating an 'illusion of financial prosperity'.[60]

Usually, employees are also the last to find out about business restructures that adversely affect their interests. Business restructuring has become an increasingly prominent feature of the Australian economic landscape over the last twenty years or so,[61] leading to the retrenchment of several million workers.[62] Recent examples have included relocations, closures and large-scale job cuts at major companies like Arnott's, South Pacific Tyres, Coles Myer, Optus, Vodafone, AMP, Telstra,

[54] *Corporations Act*, sections 555-556.

[55] See eg Robbie Campo, 'The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian Initiatives in the Light of International Models' (2000) 13 *Australian Journal of Labour Law* 236; and see further below.

[56] Richard Mitchell, Anthony O'Donnell and Ian Ramsay, *Shareholder Value and Employee Interests: Intersections Between Corporate Governance, Corporate Law and Labour Law* (2005) CCLSR/CELRL Research Report (2005) p 25; Paula Darvas, "Employee's Rights and Entitlements and Insolvency: Regulatory Rationale, Legal Issues and Proposed Solutions" (1999) 17 *Company and Securities Law Journal* 106, 108.

[57] See J Adams and N Jones, 'Distressed businesses – preventing failure' in CCH, *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia*, CCH Australia Ltd, Sydney, 2001, 185.

[58] Ibid 189; see also J Riley, 'Locating Labour's Voice in Corporate Enterprise: Lessons from Ansett', Paper to the Corporate Law Teachers' Association Conference, Melbourne, February 2002, 4.

[59] Adams and Jones, above n 57, 189-190.

[60] CCH, *Australian Labour Law Reporter*, para 1-515.

[61] See eg Peter Dawkins, Craig Littler, Ma Rebecca Valenzuela and Ben Jensen, *The Contours of Restructuring and Downsizing in Australia* (1999).

[62] ABS, *Retrenchment and Redundancy, Australia* (Catalogue No 6266.0) (September 1998 and August 2002).

Commonwealth Bank, Mitsubishi and (most recently) Holden.[63] These examples have highlighted an important deficiency in Australian law – the fact that, although their interests are directly and vitally affected when companies restructure or face insolvency, employees have few rights to information or any opportunity for input into decision making in these situations. Labour law provides unions with minimal rights to seek orders compelling employers to consult over large-scale redundancies, although the effectiveness of these provisions has been questioned.[64] However, a quarter of the almost 600,000 Australian workers made redundant between 1998 and 2001 received less than one day's notice of their dismissal.[65] This leaves employees poorly positioned to deal with the implications of events that have such serious consequences for them and their families.

(c)1.2 Recent Moves to Accommodate Employee Interests

In a number of high-profile company collapses – primarily, National Textiles in early 2000, and One.Tel and Ansett in 2001 – large numbers of employees lost unpaid entitlements to annual leave, long service leave and the like, and missed out on redundancy payments prescribed in industrial awards and agreements. In response, the Federal Government has implemented the following legislative and policy initiatives:

- *Corporations Law Amendment (Employee Entitlements) Act 2000*, introducing Part 5.8A into the *Corporations Act* which builds on the existing duty of directors to prevent companies from trading whilst insolvent,[66] by imposing personal liability on directors where they enter into "uncommercial transactions" – that is agreements, transactions, or corporate restructures which are *intended* to prevent workers from accessing their accrued employment entitlements. Heavy penalties, including fines and imprisonment, are available to deal with breaches of the "uncommercial transactions" provisions, and employee creditors can themselves initiate legal proceedings with the liquidator's permission. However, the significant problems with proving that directors were acting with the requisite intention under these provisions "inevitably limit [their] scope and effectiveness as a protective mechanism for employees".[67] There have been no reported cases to date involving a successful action by employees under these provisions.

- *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003,* prompted mainly by the One.Tel collapse in 2001, inserting section 588FDA in the *Corporations Act* to enable the recovery by a liquidator of excessive bonuses that

[63] See eg CCH, *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia* (2001).

[64] *Workplace Relations Act 1996* (Cth) ss 170FA and 170GA; see Anthony Forsyth, "Giving Teeth to the Statutory Obligation to Consult over Redundancies" (2002) 15 *Australian Journal of Labour Law* 177.

[65] ABS (2002), above n 62.

[66] *Corporations Act 2001* (Cth), sections 588G and following.

[67] Jennifer Hill, "Corporate Governance and the Role of the Employee" in P Gollan and G Patmore (eds), *Partnership at Work*, 110, 119; see further Symes, above n 53, 144-145.

have been paid to directors in circumstances where a company is in no financial position to make such payments.

- The General Employee Entitlements and Redundancy Scheme ("GEERS") scheme was introduced in the wake of the Ansett collapse, replacing the former Employee Entitlements and Support Scheme. GEERS enables employees of insolvent companies to claim recovery of their unpaid entitlements from a government fund. The establishment of such a "safety net" mechanism represents a significant improvement in the level of protection offered to employees. However, it operates subject to a number of important limitations, including a limit of 8 weeks' redundancy pay (when many employees are legally entitled to far greater severance payments under industrial awards or agreements), and an overall "cap" of $94,900 on the level at which entitlements paid out under the scheme are to be calculated.[68] The future viability of GEERS may also be in some doubt, following a recent Federal Court decision indicating that the Federal Government does not have enforceable "creditor" rights to recover payments made to employees under GEERS, in respect of companies subject to a deed of company arrangement.[69] It should also be noted that the existence of a government-funded scheme arguably discourages directors from taking greater responsibility for ensuring that companies have sufficient assets to meet their employees' entitlements. While the outcome of GEERS in terms of employee protection is commendable, the public policy benefit of effectively transferring directors' potential liability to taxpayers is questionable.

- Following the Ansett collapse, the Federal Government promised to place employees ahead of secured creditors in the statutory priority list for distribution of company assets upon insolvency. However, nearly four years later, no legislation to implement this change has yet materialised.[70]

It is important to note that employees have received very little attention in the extensive debate over corporate governance reform in Australia. Rather, the debate has been overwhelmingly shareholder-centred, with legislative responses aimed at improving board relationships with shareholders, and auditor independence.[71] These reform measures make little or no mention of employees, partly because political actors representing workers' interests (such as the ACTU and the federal Labor Opposition) have not sought to take the corporate governance debate in this direction.

[68] For further detail, see the GEERS Operational Arrangements available at: http://www.workplace.gov.au/workplace/Category/SchemesInitiatives/EmployeeEntitlements/GEERS/GeneralEmployeeEntitlementsandRedundancyScheme.htm.

[69] See *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd (Receivers and Managers Appointed)* [2005] FCA 902 (1 July 2005).

[70] As at March 2004, the federal Treasury Department was reportedly still consulting on these proposals: M Priest, "States want 'workers first' legislation", *Australian Financial Review,* 19 March 2004.

[71] Andrew Clarke, "The Relative Position of Employees in the Corporate Governance Context: An International Comparison" (2004) 32 *Australian Business Law Review* 111; Paul von Nessen, 'Corporate Governance in Australia: Converging with International Developments' (2003) 15 *Australian Journal of Corporate Law* 1.

Rather, they have supported moves to strengthen the requirements for independent company auditors, and increased shareholder scrutiny of executive remuneration.[72]

Several academics have lamented the narrow focus of the corporate governance debate in Australia, arguing that it should be broadened to consider options such as employee representation on company boards.[73] The ACTU has embarked on a strategy of 'shareholder activism', seeking to utilise the combined voting power of employee and superannuation fund shareholdings to influence decision-making and question management about retrenchments, wage disparities and other issues at company annual general meetings.[74] Similarly, it has endorsed the idea of 'boardroom activism', encouraging union representatives on superannuation fund boards to use their positions to ensure 'socially responsible' investment decisions.[75] Several unions have also tried (unsuccessfully) to obtain seats on the boards of major companies. At this stage, the ACTU has not embraced the idea of legally-mandated employee representation at board level.

In contrast, employees have figured far more prominently in the debate over corporate governance reform in the UK. This has included consideration of a 'major redesign of [company] decision-making structures to permit participation by the relevant stakeholder groups', such as employees[76] (see further Part (g) below). Although inter-connected with labour regulation, Australian corporations law must follow the UK path and be substantially re-shaped to enhance the voice of workers in corporate enterprises.[77]

[72] See eg Senator Stephen Conroy, *Directions Statement: Improving Corporate Governance* (2002); ACTU, *Corporate Governance Policy* (ACTU Congress 2003).

[73] See eg R Markey, "A Stakeholder Approach to Corporate Governance: Employee Representatives on Boards of Management" in Gollan and Patmore, 122, 132-3; Clarke (2004), above n 71, 114, 119, 130-1.

[74] See eg ACTU, *Corporate Governance Background Paper* (ACTU Congress 2003); Greg Combet, *Superannuation, Unions and Good Labour Relations* (Address to the Conference of Major Superannuation Funds, Ashmore, 14 March 2002).

[75] See Sharan Burrow, 'Whispers Outside the Boardroom Door: Making Working Australia's Money Talk' (Address to the Sydney Institute, Sydney, 29 August 2000); Greg Combet, *Speech to ACSI Corporate Governance Conference*, 9 July 2005.

[76] John Parkinson, 'Models of the Company and the Employment Relationship' (2003) 41 *British Journal of Industrial Relations* 481, 499-504; see also Paul Davies, 'Employee Representation and Corporate Law Reform: A Comment from the United Kingdom' (2000) 22 *Comparative Labor Law and Policy Journal* 135; Janet Williamson, 'A Trade Union Congress Perspective on The Company Law Review and Corporate Governance Reform since 1997' (2003) 41 *British Journal of Industrial Relations* 511.

[77] Several options are discussed in Part (d) below; other options traditionally falling more within the realm of labour law than corporate law, including 'partnership' strategies and information and consultation rights modelled on European Union directives, should also be explored; for detailed discussion, see Anthony Forsyth, *Transplanting Social Partnership: Can Australia Borrow from European Law to Improve Employee Participation Rights in Business Restructuring?* (Unpublished PhD Thesis, University of Melbourne, 2005); and Anthony Forsyth, 'Corporate Collapses and Employees' Right to Know: An Issue for Corporate Law or Labour Law?' (2003) 31 *Australian Business Law Review* 81.

(c)(2) The Position of the Environment under Australian Corporate Law

(c)2.1 The General Position

The general position with respect to the environment is similar to that described for employees. Company law provides only that directors have a broad duty to act in the best interests of the company. Thus directors may only sacrifice profits for protection of the environment if this coincides with the profit-making objectives of the company.

(c)2.2 Recent moves to Encourage Corporate Environmental Responsibility

Of course the Federal government has made some response to the growing calls for measures to encourage corporate environmental responsibility, including the following amendments to the *Corporations Act*:

(c)2.2.1 Mandatory environmental reporting - s 299(1)(f)

Paragraph 299(1)(f) was introduced into the *Corporations Act* in 1998. It provides a rather vague obligation for a director's report to include 'details of the entity's performance' in relation to any 'particular and significant' environmental regulation under a law of the Commonwealth or of a State or Territory. This provision in particular and the concept of mandatory environmental reporting in general have been strongly criticised by business groups and a 1999 Parliamentary Committee concluded that the provision should be repealed on the following grounds:[78]

- that environmental reporting is not a matter for the Corporations Act
- the provision is vague and uncertain
- the provision is of limited practical effect as it duplicates other reporting obligations, with additional cost
- the desirability for environmental reporting to develop in a non-prescriptive manner rather than as a response to government mandate.

In our view the Committee's conclusions were poorly reasoned and are certainly not justified. To suggest that environmental matters have no place in corporations law is simply an outmoded and unrealistic view contrary to Australia's obligations under various international agreements like the *Rio Declaration* as well as the Federal Government's own policy under the *National Strategy for Ecologically Sustainable Development*. It is easily demonstrated that environmental risks cannot be separated from the various financial considerations dealt with at length in the *Corporations Act*. The vagueness and uncertainty of s 299(1)(f) do not justify removal of the provision, as it is clearly a useful measure which is consistent in principle with international best practice; eg. see the Global Reporting Initiative.[79] However, the provision needs to be

[78] Parliamentary Joint Standing Committee on Corporations and Securities, *Matters Arising from Company Law Review Act 1988* (AGPS, Canberra, October 1999.

[79] The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. GRI is an official collaborating centre of the United Nations Environment Programme (UNEP) and

reformed to provide for more comprehensive and uniform disclosure to meet world best practice. The other two objections lack substance as many researchers have found that s 299(1)(f) has markedly improved the standard of environmental reporting by corporations.[80]

It can be argued that stronger environmental reporting is already required under the existing obligations of company directors. Sean Lucy and Megan Utter have argued that directors' reporting obligations under s 295 of the *Corporations Act*, requiring that company financial statements must give a 'true and fair view' of 'the financial position and performance of the company', necessitates careful consideration of the environmental sustainability of the company's operations.[81] They point out that there is a growing trend for the intangible aspects of a company's business to make up the bulk of the value of the company, and that this value is highly vulnerable to environmental risks. This is highly pertinent in industries associated with climate change, where sectors like motor vehicle manufacturing and coal fired power generation are vulnerable to declining profitability. It is argued that directors who do not report on such matters may subsequently be sued by disgruntled investors. However, it s 295 does not provide a sufficient basis for full environmental disclosure.

(c)2.2.2 Minority shareholder resolutions – s 249D

Another relevant measure introduced into the *Corporations Act* in 1998 was s 249D, which enabled either a minimum of 100 shareholders, or 5% of all shareholders, to put a resolution to an extraordinary general meeting. This has led to several instances of environmental activism by minority shareholders of companies such as North Ltd and Gunns Ltd.[82]

(c)2.2.3 Product Disclosure Statements – s 1013DA

Under the recent Financial Services Reforms, a new financial product disclosure requirement was introduced into the *Corporations Act* under s 1013DA. This provision requires 'product disclosure statements' to indicate whether labour standards, environmental considerations, social considerations or ethical considerations have been taken into account by the product issuer in selecting retaining or realizing an investment.

works in cooperation with UN Secretary-General Kofi Annan's Global Compact. See the GRI website at: http://www.globalreporting.org/index.asp

[80] See eg G R Frost (2001) 'An Investigation of Mandatory Environmental Reporting in Australia' Paper presented to the *Third Asia Pacific Interdisciplinary Research in Accounting Conference*, 15-17 July 2001 Adelaide.

[81] Sean Lucy and Megan Utter, 'Directors' duties and sustainability: Are you being true and fair?' *Keeping Good Companies* , February 2004 at 40.

[82] See Paula Darvas 'Section 249D and the 'Activist' Shareholder: Court Jester or the Conscience of the Corporation?" (2002) 20 *Company and Securities Law Journal* 390, and Shelley Bielefeld, Sue Higginson, Jim Jackson and Aidan Rickets, 'Director's duties to the company and minority shareholder activism' (2004) 23 *Company and Securities Law Journal* 28.

These three ‘environmental’ measures have made a useful contribution but overall their effect on corporate behaviour is quite limited. However, a more significant factor is the range of specific environmental obligations that corporations face under State and Federal laws. It is necessary to review the effectiveness of these specific obligations in order to understand the appropriate role of corporations law.

(c)2.3 The effectiveness of specific environmental regulation

Company directors must always ensure that the company meets a wide range of specific environmental obligations under State and federal laws on a wide range of environmental matters, like the use of toxic chemicals, industrial pollution, waste disposal and the protection of nature resources. These specific environmental obligations are generally regulated by State Environment Protection Authorities and Natural Resources departments. Unfortunately, these agencies seem to be failing in their task. Peter Christoff has recently stated:

> Australian EPAs lack the capacity – and often the will – to fulfil their mandate … Yet it is also obvious that there are fundamental limits to what such localised agencies can achieve. The widely held expectation that EPAs can, given their present resources and regulatory scope and culture, guide complex economies towards ecological sustainability is manifestly unrealistic.[83]

With regard to forestry in Victoria, Andrew Walker has recently described a series of serious deficiencies in the forestry controls including a lack of ecologically sustainable management principles, effective exemption from the biodiversity protection legislation, absence of environmental impact assessment procedures, lack of accountability and transparency and a lack of community participation.[84]

At the federal level, the most relevant environmental legislation is the *Environment Protection and Biodiversity Conservation Act 1999* (Cth). This Act establishes a comprehensive scheme for environmental impact assessment of new proposals which may have a significant impact on certain specified ‘matters of national environmental significance’ as well as a range of biodiversity protection measures. The impact assessment function is restricted to certain specified matters based upon international obligations under various treaties like the World Heritage Convention, the Ramsar Wetlands Convention and the Biodiversity Convention.

This reflects a political compromise reached between the Federal Government and the States in 1992 after many bitter disputes over environmental matters in the 1970s (eg. the Tasmanian dams case). Andrew McIntosh has recently concluded that this Act is not meeting its environmental protection objectives due to a combination of administrative failings and structural flaws (including exemptions for existing uses and forestry operations, and a failure to specifically deal with land degradation and

[83] P Christoff, 'EPAs -the orphan agencies of environmental protection' in S Dovers & S Wild River *Managing Australia’s Environment,* The Federation Press, Sydney, 2003 at 316.

[84] Andrew Walker, ‘Forest Reform In Victoria: Towards ecologically sustainable forest management or mere greenwash?’ (2004) 29:2 *Alternative Law Journal* 58 (Apr 2004).

climate change).[85] This is not surprising due to the flawed structure of this Act which attempts to divide up discrete areas of environmental management between federal and state governments, and in particular, to leave most resource use issues to the States.

These weaknesses in the framework of specific environmental obligations have increasingly placed corporations in the role of primary protector of the environment, and thus under the present law, its protection now largely depends upon voluntary actions by corporations. The limited effectiveness of reliance upon voluntary corporate action can be illustrated by a range of recent examples:

- BHP Ltd mining operations at Ok Tedi in Papua-New Guinea, between 1994 and 1996 which destroyed the traditional lifestyle of some 30,000 landowners in the Fly River catchment.[86]

- forestry in Tasmania, where Gunns Ltd has a very poor record with respect to clear felling of native forests[87], misuse of pesticides[88] undue influence over government agencies,[89] and using legal proceedings against the Wilderness Society and other community activists.[90]

- the Shell Oil Refinery at Corio Bay, which has breached environmental standards several hundred times in recent years. The company has been content to regularly pay modest fines imposed by the Magistrates Court rather

[85] Andrew Macintosh, 'Why the EPBC Act's referral assessment and approval process is failing to achieve its environmental objectives' (2004) 21 *Environmental and Planning Law Journal* 288.

[86] In 1995, the PNG landowners filed a $4 billion damage claim against BHP in the Victorian Supreme Court for economic loss and environmental damage, and argued that BHP be forced to build a tailings dam instead of letting mine waste flow down the river systems. BHP responded by secretly drafting legislation for the PNG government that would make it a criminal offence to take legal action against BHP in courts outside Papua New Guinea. BHP was found guilty of contempt of court, causing its share prices to plummet. The contempt finding was later overturned on appeal on a technicality.

[87] See the many submissions about unsustainable forestry practices made to the Senate Rural and Regional Affairs and Transport References Committee Inquiry: *Australian Forest Plantations A Review of Plantations for Australia: The 2020 Vision. Submissions to this inquiry are available at: http://www.aph.gov.au/Senate/committee/rrat_ctte/completed_inquiries/2002-04/plantation_forests/index.htm.*

[88] See NineMSN Sunday Program, September 26 2004, 'Name Your Poison' which investigated the misuse of chemicals and water contamination linked with public health problems in St Helens and death of oysters in Georges Bay, north-east Tasmania. Transcript available at: http://sunday.ninemsn.com.au/sunday/cover_stories/article_1649.asp.

[89] Forestry Tasmania, the government agency which administers forestry operations in Tasmania, has been exempted from Freedom of Information laws in that State.

[90] See Friends of the Earth (2004) 'Gunns Action Threatens Free Speech' Press Release 20 December 2004 available at: http://www.foe.org.au/mr/mr_20_12_04.htm, and Andrew Darby, (2005) 'Lawyers, Gunns and forests' *Sydney Morning Herald*, January 27, 2005.

than make the necessary capital investment needed to prevent these problems. Meanwhile the EPA has failed to take stronger action.[91]

- the expansion of unsustainable agricultural ventures, such as irrigated cotton which been responsible for excessive water diversion in the Murray Darling system[92] and increasing chemical discharges to the Great Barrier Reef in Queensland[93].

These examples indicate some serious general problems in the regulation of environmental issues in Australia:

- Firstly, they reinforce the view that the mandatory government controls over corporate environmental impacts are often inadequate (particularly in 'rogue' states).

- Secondly, even where government regulation is adequate, it may not be enforced due to 'capture' of the regulators, particularly where large corporations attract valuable economic development to a region.

- Thirdly, that corporate decision making is more often the critical process that determines the real extent of environmental damage (or protection).

- Fourthly, that within that corporate decision making process, conflicts between profit maximisation and environmental responsibility are generally exercised in favour of the short term interests of shareholders rather than the long term interests of the broader community.

- Fifthly, they demonstrate that 'top-down' models of environmental regulation are not sufficient. These failures illustrate the importance of engagement of community stakeholders and industry managers in the relevant decision-making processes.

The examples also reveal some common weaknesses in corporate decision-making processes:

- Inadequate disclosure of environmental impacts;

[91] An investigation in 2003 revealed Shell had committed more than 300 environmental breaches in the prior two years, including 145 between June and September 2003. It had been fined just 31 times for those breaches. See *The Age* 11 November 2003, 'The Shell refinery: an issue on the nose'
For a more recent incident, see press report by Ewin Hannan 'Shell under fire over secrecy on discharges', *The Age*, Melbourne, 18 August 2005.

[92] Within the last ten years, irrigation properties on the lower Ballone river system north of the NSW border have built dams and water storage systems capable of retaining 1.2 million megalitres, or twice the water capacity of Sydney Harbour. See Peter Mac 'Agribusinesses in huge water scam', *The Guardian*, No. 1171, 18 February, 2004

[93] For example, the current dispute over the Natham Dam proposal for expansion of irrigated cotton farming in the Fitzroy River catchment in central Queensland which was the subject of a recent *ADJR Act* challenge: *Minister for the Environment and Heritage v Queensland Conservation Council Inc* [2004] FCAFC 190 (Full Court, 30 July 2004).

- Lack of stakeholder engagement in decision making; and

- Lack of commitment to the principles of sustainable development.

Fortunately, these decision-making weaknesses have been the focus a range of voluntary measures developed under State laws such as the Victorian *Environment Protection Act* 1970. These include:

- recognition of environmental management systems and environmental audits as a prerequisite for determining environmental performance to qualify as an 'accredited licencee' under s 26B of the *Environment Protection Act* 1970 (Vic); environmental management systems have also been endorsed as part of a 'minimum profile' expected where company directors seek to raise a defence of due diligence against statutory liability for environmental offences;[94]

- processes for participation of the community in corporate environmental management, as an essential prerequisite for approval of an 'environmental improvement plan' under s 31C(6) of the *Environment Protection Act* 1970 (Vic);

- the recognition of 'resource efficiency' and 'reduction of ecological impact' as key criteria for establishment of a sustainability covenant under s 49AA of the *Environment Protection Act* 1970 (Vic). These strategies focus on 'extended product responsibility', using a 'cradle to grave' approach to managing environmental impacts throughout the raw materials supply chain as well as production and downstream product distribution and waste recovery.

Together with comprehensive 'sustainability reporting', these voluntary measures are close to international 'best practice' in environmental management, and they have been willingly adopted by a growing number of environmentally responsible corporations in Victoria. Thus it is submitted here that the next phase of environmental law should make these strategies mandatory. However, in recognition of the limited jurisdictional reach and lack of resources of State environmental agencies, it is recommended that these measures will be of greatest impact if they are introduced as part of an expansion of corporate law obligations. This will be described further in Part (d) below.

d. Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders, other than shareholders, and the broader community.

(d)(1) Introduction

[94] See s 66B(1A)(c) of the *Environment Protection Act* 1970 (Vic) and the comments on due diligence by Ormston J in *R v Bata Industries Ltd et al* (1992) 70 CCC (3d) 394 (Canada).

The economic theories outlined in Part (b) above recognise that there are non-shareholder stakeholders that are vulnerable to abuse of power by corporations because of their inability to protect their own interests. This is specifically acknowledged by the growth in theories such as team production, communitarianism. and concession theory. The examination of the current legal framework under Part (c) revealed that there is currently no effective framework for corporations to take these non-shareholder interests into account.

What is needed, therefore, is guidance as to how these interests are to be considered and protected. According to Millon, communitarians are characterised by their 'willingness to use legal intervention to overcome the transaction costs and market failures that impede self-protection through contract.'[95] He contended:

> If one discards the view that bargaining is sufficient to mediate among those interests, reform of the rules structuring corporate governance presents an opportunity to develop rational, well-considered regulation of relations among shareholders and non-shareholders. Perhaps supplemented by public law interventions, this approach seems preferable to a number of uncoordinated, ad hoc reform efforts, in various discrete areas of the law, that ignore the need for systematic balancing of shareholder and non shareholder interests.[96]

In order to genuinely protect non-shareholder constituencies, legislation would need to be passed to mandate directors to consider their interests in situations where there is a conflict with the interests of shareholders and the shareholder profit maximisation objective. The issue of when such interests are to be given priority is problematic. However, as has been demonstrated in earlier parts of this submission, non-shareholder cohorts are most vulnerable when the company is in financial distress and the directors are desperately seeking to keep it afloat. For these reasons, sanctions need to be targeted against directors' personal assets, to deter them from any improper behaviour in such situations. This would justify the imposition of financial penalties and other sanctions against directors for breach of any new duty to consider stakeholder interests (see further below).

It is submitted that the approach of mandating directors to take into account social, environmental and other stakeholder interests is not a radical step, as progressive corporations are already prepared to promote themselves as socially responsible in accordance with various voluntary CSR strategies. However, the absence of mandatory decision making criteria on these matters at the corporate level often allows social and environmental considerations to either escape notice, or be deliberately ignored. Arguments that shareholder interests are threatened by new obligations of this kind may be largely illusory. The growth of institutional shareholders and the likelihood that most shareholders will have diverse holdings across many corporations and industry sectors (either directly or through superannuation funds), means that there is now a much greater commonality of interest between shareholders and the broader community.

[95] Millon, 'Communitarians' above n 33, 1379.

[96] Millon, 'Communitarians' above n 33, 1386-7.

(d)(2) Recommendations for new directors' duties to recognise stakeholder interests in company decision making

Accordingly, we recommend that the duty of directors under the *Corporations Act* to act in good faith in the best interests of the company should be amended to enable and, in certain circumstances, require directors to consider the interests of non-shareholder stakeholders.

The essence of these additional duties upon directors is to reform corporate disclosure and decision making processes by mandating for all corporations the best practice on social and environmental responsibility already implemented voluntarily by many progressive corporations in Australia.

By way of enforcement, the civil penalty regime discussed below will be extended to provide standing for appropriate non-shareholder stakeholders to seek remedies including civil penalties, injunctions and declarations.

The new duties would have the following elements:

(d)2.1 A *permissive* aspect having general application:

- That is, it would be made clear that directors *may* consider the interests of employees, the environment, creditors, consumers, and other stakeholders in the normal course of company decision-making, even where this would conflict with the interests of shareholders and the shareholder profit maximisation objective.
- The legislation would need to provide some guidance for directors as to when stakeholder interests may be prioritised ahead of those of shareholders. Usually, this would be the case where it is necessary to ensure that the company meets its obligations under other relevant laws, such as employment and occupational health and safety standards, environmental regulations, and the like.
- The legislation could take this a step further by enshrining higher standards of corporate behaviour, the observance of which would enable a director to put stakeholder interests ahead of those of shareholders. That is, rather than simply promoting *observance* of existing laws, the new duty could allow directors to take active steps to *exceed* those standards – for example, by tying increases in executive remuneration to the level of salary increases for the regular workforce, even though no labour law or corporate law rules require directors to do so.
- Directors could also be permitted to place stakeholders' interests ahead of shareholders', where the company's reputation or long-term viability would be at risk if the directors failed to do so. This would involve legislative recognition of directors' capacity to act *other* than with a view to ensuring short-term returns to shareholders, and enabling them to act in accordance with the principle of "enlightened shareholder value" (in line with current law reform proposals in the United Kingdom)[97].

[97] See further Part (e) below.

(d)2.2 A *mandatory* aspect having specific application:

- That is, *requiring* directors to prioritise stakeholder interests over those of shareholders, where the risk of stakeholder interests suffering adverse treatment is particularly heightened – primarily, when the company is encountering financial difficulty and may, or has, become insolvent.
- The relevant stakeholder individual(s) or group(s) could be required to show that its/their interests were "substantially prejudiced" by the directors' actions or proposed actions, in order to show a breach of this aspect of the new directors' duties.

(d)2.3 Two further *mandatory* aspects to specifically address employee interests:

(i) In the insolvency or near-insolvency situation, the interests of employees warrant particular protection from steps being taken by directors to deplete company assets, or to preserve such assets for the benefit of directors and shareholders at the expense of employees.

- Further specific obligations should be imposed on directors to prevent such behaviour. A duty on directors aimed at achieving this objective should not be based on the necessity of proving that directors intended to cause detriment to employees, as is currently the case under Part 5.8A of the *Corporations Act*.
- Rather, it should be sufficient to show that a director acting reasonably in such circumstances would have taken steps to safeguard the accrued entitlements and other amounts owed to employees.

(ii) Consideration should also be given to ensuring the recognition of employee interests whenever the company is considering a reorganisation or restructure that could have a detrimental impact on employees, such as large-scale redundancies.

- Companies frequently implement such decisions with the stated aim of enhancing "shareholder value". However, it may be necessary to require directors to demonstrate that they have considered the impact of these restructuring decisions on employees, and explored all available alternatives, before implementing them.
- This could be done through the imposition of a specific duty in the *Corporations Act* to this effect, which directors could "opt out" of by showing that the company has established permanent structures for ongoing consultation with employees about major business and investment decisions.
- For example, the creation of specially-constituted board committees with employee representatives,[98] or worker-elected

[98] See R Markey, 'A Stakeholder Approach to Corporate Governance: Employee Representatives on Boards of Management' in P Gollan and G Patmore (eds), *Partnership at Work*, 122.

councils,[99] with access to company financial information and consultation rights in relation to strategic business decisions, would enable a company to exercise the "opt out" from the obligation to consider employee interests in restructuring situations.

- It is acknowledged that works councils, mandatory employee representation at board level, and other features of "stakeholder"-oriented corporate governance systems may not be readily adaptable to the Australia's shareholder-focused business culture.[100]
- However, the encouragement of these types of innovative institutional arrangements as a backdrop to a new obligation to consider employee interests in specific cases of restructuring would give businesses the capacity to fashion such arrangements to their own circumstances.

(d)2.4 Four further *mandatory* duties to specifically address the interests of the broader community in achieving ecologically sustainable development and protection of the natural environment:

(i) Directors must prepare and publish an annual environmental impact and ecological sustainability report in accordance with international best practice; eg. the Global Reporting Initiative or similar guidelines. This report shall be integrated with the financial reporting obligations of the company and thus subject to audit along with the financial report.

(ii) Directors must ensure that each distinct business division of the company establishes and maintains an appropriate environmental management system to be verified by ISO 14001 accreditation. A mandatory independent environmental auditing process should be introduced to monitor this requirement.

(iii)Directors must prepare and implement an appropriate 'environmental improvement plan' as a mandatory component of the environmental management system. This plan will establish procedures to improve the ecological sustainability of all company activities, with special attention to 'resource efficiency' and 'reduction of ecological impact' following appropriate principles of extended product responsibility.

(iv)Directors must regularly consult with the local community in relation to all activities that have a significant impact upon the natural environment. For this purpose the company shall establish a 'community consultative

[99] See Anthony Forsyth, 'Giving Employees a Voice over Business Restructuring: A Role for Works Councils in Australia' in P Gollan and G Patmore (eds), *Partnership at Work*, 140.

[100] On the distinction between shareholder-centred (Anglo-American) and stakeholder (continental European) corporate governance models, see eg Parkinson, above n 76; Jeswald Salacuse, 'Corporate Governance, Culture and Convergence: Corporations American Style or with a European Touch?' (2003) 14 *European Business Law Review* 471.

committee' which includes at least one board member and the senior environmental manager together with an appropriate range of community representatives.

(d)(3) Enforcement mechanisms

Consideration also needs to be given to the question of how best to enforce the new directors' duties outlined above. In our view, the proposed duties should be enforced by the civil penalty regime contained in Part 9.4B of the *Corporations Act*. This would be desirable for two reasons. First, it would provide consistency as the current directors' duties are enforced by this regime and secondly, the regime has been proven to be effective in the enforcement of those duties. Only those duties cast in mandatory terms (that is, those described in paras (d)(2.2)-(2.4) above) would lend themselves to enforcement through these mechanisms.

(d)3.1 Civil penalty provisions

Civil penalty provisions are "punitive sanctions that are imposed otherwise than through the normal criminal process." [101] These provisions were introduced to assist ASIC in its role as the regulator of corporate law.[102] Civil penalty provisions provide an alternative to traditional criminal enforcement regimes. These penalties fall between civil actions for damages and criminal prosecutions. Just as it does in a criminal matter, a court may impose a civil penalty when an adverse finding has been made against a defendant. However, the rules of evidence and procedure applicable to a hearing for a civil penalty are civil, not criminal.[103] Civil penalties are attractive enforcement mechanisms because they allow ASIC to obtain an enforcement order on the civil standard of proof. The increased likelihood of a civil penalty order being made against a director provides an increased deterrent to encourage him or her to comply with the directors' duties.

The imposition of a civil penalty does not amount to a criminal conviction. Usually the behavior that attracts a civil penalty does not involve any connotation of the commission of a crime.[104] It is argued that the stigma that would follow a criminal conviction does not attach to a civil penalty.[105] Incarceration is reserved for criminal offences and is never available as a civil penalty. As the type of conduct that attracts these civil penalties is not regarded as criminal, incarceration is deemed to be inappropriate.[106]

[101] Michael Gillooly and Nii Lante Wallace-Bruce, 'Civil Penalties in Australian Legislation' (1994) 13 (2) *University of Tasmania Law Review* 269, 269.

[102] Vicki Comino, 'National Regulation of Corporate Crime' (1997) 5 *Current Commercial Law* 84, 91 and 92; and Explanatory Memorandum, Corporate Law Reform Bill 1992, paras 61 and 113.

[103] *Corporations Act 2001* (Cth) s 1317L.

[104] Harold Ford and Robert Austin, *Principles of Corporations Law* (9th ed, 1999) 83.

[105] Gillooly and Wallace-Bruce, above n 101, 289.

[106] Ibid.

Certain provisions of the *Corporations Act* are deemed to be "civil penalty provisions" and are subject to the civil penalty regime.[107] The civil penalty provisions are categorised as corporation/scheme civil penalty provisions or financial services civil penalty provisions.[108] The corporation/scheme civil penalty provisions include the directors' duty provisions. If the court is satisfied that one of the civil penalty provisions have been contravened the court is required to issue a declaration to that effect.[109] If a declaration of a contravention is made the court can ban the contravening person from managing a corporation for a period specified in the order and order the contravening person to pay a pecuniary penalty.[110] In addition, the court has the power to order the person who contravenes a corporation/scheme civil penalty provision to pay compensation to the corporation that suffers loss or damage as a result of the contravention.[111]

Whilst the number of civil penalty applications issued by ASIC is not large, ASIC is making increasing use of the civil penalty regime in high profile cases. For example, many of the cases issued since 2000 were issued against directors involved in high profile corporate collapses including the directors of the HIH group of companies, the Water Wheel groups of companies and One.Tel Ltd.

ASIC has enjoyed a high rate of success with the civil penalty applications it has issued. Research published in 2004 indicated that from March 1993 to May 2004 nineteen applications for civil penalty orders issued by ASIC were finalised.[112] ASIC was successful in all but one of these nineteen cases. Success is defined as the obtaining of a declaration that a contravention of a civil penalty provision had occurred and the subsequent making of civil penalty orders.

The successful use by ASIC of the civil penalty regime in high profile cases sends an important message to directors and the community. ASIC has at its disposal enforcement mechanisms which allow it to successfully pursue actions against directors who contravene the provisions of the *Corporations Act*. The proposed duty mandating directors to consider other stakeholders' interests in situations where there is a conflict with the interests of shareholders and the shareholder profit maximisation objective should be made subject to the civil penalty regime so that ASIC can successfully pursue actions against directors who contravene this duty.

[107] *Corporations Act* 2001 (Cth) ss 1317E(1).

[108] *Corporations Act* 2001 (Cth) s 1317DA.

[109] *Corporations Act* 2001 (Cth) s 1317E.

[110] *Corporations Act* 2001 (Cth) s 206C and 1317G.

[111] *Corporations Act* 2001 (Cth) s 1317H.

[112] Michelle Welsh, 'Eleven Years On – An Examination of ASIC's Use of an Expanding Civil Penalty Regime' (1994) 17 *Australian Journal of Corporate Law* 175.

(d)3.2 What changes would need to be made to the regime?

Amendments would need to be made to the civil penalty regime to allow the proposed duty to be enforced effectively and to allow the benefits of that enforcement action to flow to the victims of the contravention. In relation to a contravention of the directors' duty provisions the current civil penalty regime does not contemplate enforcement action being taken by stakeholders other than ASIC or the company to whom the directors' duties are owed. Only ASIC and the company affected by the contravention can seek orders under the civil penalty regime.[113] No other person may apply for a declaration of a contravention, a pecuniary penalty order or a compensation order.[114] Stakeholders other than the company have no standing to apply for a compensation order.

In addition, the current provisions do not allow ASIC to seek compensation on behalf of stakeholders other than the company. Where the directors' duties have been contravened and damage results from the contravention the court may order a person to compensate the corporation who suffered damage as a result of the contravention.[115] The provisions do not allow the court to make a compensation order in favor of any other stakeholders.

The civil penalty regime would need to be amended to give stakeholders other than the company standing under the regime. In addition the orders available to the court would need to be expanded so that compensation could be awarded to stakeholders other than the company. This would allow ASIC to apply for compensation orders in favour of these stakeholders. In addition, stakeholders themselves would be able to apply for a compensation order.

There is some precedent for this type of order. As stated previously the provisions of the *Corporations Act* that are enforced by the current civil penalty regime are categorised as either corporation/scheme civil penalty provisions or financial services civil penalty provisions. The directors' duty provisions are categorised as corporation/scheme civil penalty provisions. Provisions such as the continuous disclosure and market manipulation provisions are categorised as financial services civil penalty provisions.116

The orders available for a contravention of a financial services civil penalty provision are wider than the orders available for a contravention of the corporation/scheme civil penalty provisions. If a financial services civil penalty provision has been contravened the court may make a compensation order in favour of any person (including a corporation), or a registered scheme, for damage suffered by that person or scheme.[117]

[113] *Corporations Act* 2001 (Cth) s 1317J.

[114] *Corporations Act* 2001 (Cth) ss 1317J(4).

[115] *Corporations Act* 2001 (Cth) ss 1317H(1).

[116] *Corporations Act* 2001 (Cth) s 1317DA.

[117] *Corporations Act* 2001 (Cth) s 1317HA.

The difference between the compensation orders available for corporation/scheme and financial services civil penalty provisions is that under the former, compensation can be awarded in favour of the corporation or registered scheme whereas under the latter an order for compensation can be made in favour of a corporation, a registered scheme or a person for damage suffered by the corporation, scheme or person. In addition, persons who suffer damage in relation to a contravention, or alleged contravention, of a financial services civil penalty provision have standing to apply for a compensation order.[118]

In order to encourage directors to have regard for the interests of stakeholders, other than shareholders, and the broader community, the orders available for contravention of the proposed duties and the persons who have standing to apply for those orders should be the same as those currently provided for a contravention of the financial services civil penalty provisions.

(d)3.3 Standing for environmental breaches

With regard to a breach of the new 'environmental' duties proposed above, the standing rules will need to be extended beyond the existing classes of 'a person whose interests have been, are or would be affected' (under the injunction provision, s 1324) and 'any other person who suffers damage' (under the financial services penalty provision, s 1317J). It is submitted that the appropriate standing rule for a breach of environmental obligations should be based upon the concept of an 'interested person' in s 475(6) of the *Environment Protection and Biodiversity Conservation Act 1999* (Cth), which extends standing to any individual or organisation engaged in activities or research for protection or conservation of the environment.[119]

(d)3.4 Strategic regulation theory

To be effective an enforcement regime should comply with strategic regulation theory. Strategic regulation theory is an economic theory of regulation under which a regulator's goal is defined as being the need to secure compliance with the law. This theory offers guidelines as to how that compliance may be best secured. It requires the regulator to be equipped with a range of sanctions that are ordered from the least to the most severe.

Strategic regulation theory advocates that regulators are best served to attempt to secure regulatory compliance by persuasion rather than through punishment. Persuasive measures will be less costly than legal enforcement through punishment. However for persuasion to be effective it must be backed up by a real threat of punishment. The punishment that can be threatened should consist of a set of

[118] *Corporations Act* 2001 (Cth) ss 1317J(3A).

[119] This rule has been successfully used by environmental groups in several *EPBC Act* applications; for example see *Booth v Bosworth* [2001] FCA 1453 (17 October 2001) and *Queensland Conservation Council Inc v Minister for the Environment and Heritage* [2003] FCA 1463.

integrated sanctions escalating in severity in proportion to the contravention that has been committed.[120]

Usually strategic regulation theory is represented graphically by the pyramid model. The pyramid model was developed and expanded by John Braithwaite, Brent Fisse and Ian Ayres.[121] The pyramid model requires the regulator to be armed with a range of sanctions that escalate in severity from education and persuasion at the base, through various other stages in the middle to incarceration of individuals or winding up of companies at the apex. The regulatory agency should move from one level to another, commencing at the lowest level in the majority of cases.

As stated previously the directors' duties are currently enforced by the civil penalty regime. In addition to civil liability criminal penalties are available for the most severe cases. For example criminal sanctions can be imposed when a director is reckless or intentionally dishonest and breaches his or her duty to act in good faith in the best interests of the corporation.[122] Consideration would need to be given as to whether or not a director breaching the duty proposed in this submission should be subject to criminal sanctions.

In 1989 the Senate Standing Committee on Legal and Constitutional Affairs conducted an enquiry into the duties and obligations of company directors. The committee issued a report entitled 'Report on the Social and Fiduciary Duties and Obligations of Company Directors' (the Cooney Committee Report).[123] One of the matters considered by that report was whether or not criminal penalties should be imposed for breach of the directors' duty provisions.

The committee recognized that the directors' duties could be contravened at different fault levels. While criminal penalties would not be appropriate in every circumstance, these penalties should be available where the conduct in question is genuinely criminal in nature. If criminal penalties were introduced in relation to the proposed duty the enforcement regime would comply with strategic regulation theory and it would provide consistency with the enforcement regime available for the other directors' duties. However, this submission does not support the introduction of criminal liability for the new duty for the following reasons.

As noted previously expanding the directors duties may increase the reluctance of experienced, well qualified business people to take up directorships, thus depriving companies of a valuable resource. The imposition of liability may also lead to inappropriate delegation to subordinates or outside consultants to avoid directors bearing personal responsibility. Another difficulty is the cost of increased liability, as the directors may demand compensation for being exposed to it. Moreover, the fear of

[120] George Gilligan, Helen Bird and Ian Ramsay, 'Civil Penalties and the Enforcement of Directors'Duties' (1999) 22 (2) *University of NSW Law Journal* 417, 425.

[121] Brent Fisse and John Braithwaite, *Corporations Crime and Accountability* (1993).

[122] *Corporations Act 2001* (Cth) s 184.

[123] Senate Standing Committee on Legal and Constitutional Affairs, Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors, Nov 1989, AGPS (Cooney report), paras 13.3 and 13.4.

liability may make directors overly cautious. These factors will be increased to an unacceptable level if criminal liability is imposed.

In addition, there are practical reasons for not extending corporate criminal liability. Many commentators have identified the difficulties associated with the imposition of criminal liability on directors.[124] Corporate criminal offences are difficult to enforce because of the evidentiary requirements and criminal standard of proof. In many cases offenders are powerful and well resourced and are able to take advantage of the vagaries of the criminal law. A further problem is the apparent reluctance of the courts to convict white collar or corporate offenders. It has been argued that in many cases juries do not perceive business people as 'candidates for gaol'.[125] For these reasons this submission does not support the imposition of criminal liability in relation to the proposed duty.

This submission supports the expansion of the civil penalty regime to enforce the new duties. The civil penalties should be supplemented with education and persuasion strategies. If education and persuasion strategies do not work it is proposed that ASIC should be able to escalate its enforcement activities to civil penalties. Criminal penalties should not be imposed.

The proposed enforcement regime is as follows:

First Tier - Lesser penalties, education and persuasion

It is proposed that the first tier of liability should be introduced to enforce relatively minor contraventions. It could involve the director being warned, minor pecuniary penalties being imposed or orders being made that the director undertake a relevant education program or implement a relevant compliance program.

Second Tier - Civil Liability imposed pursuant to the civil penalty regime

A second tier of civil liability should be introduced. The proposed second tier would allow the current civil penalty regime to be expanded to cover the new duties. The advantages of the civil penalty regime are outlined above.

[124] See Henry Bosch, 'Bosch on Business' (1992) *Information Australia* 1, 1; Seumas Miller, 'Corporate Crime, the Excesses of the 80's and Collective Responsibility: an Ethical Perspective' (1995) 5 *Australian Journal of Corporate Law* 139, 162; Roman Tomasic, 'Corporate Crime' in Duncan Chappell and Paul Wilson, P (Eds), *The Australian Criminal Justice System The Mid l990,* (1994) 263 and Roman Tomasic, 'Corporate Crime in a Civil Law Culture' (1994) 5 *Current Issues in Criminal Justice* (3) 244, 251.

[125] Roman Tomasic, 'Corporate Crime in a Civil Law Culture' (1994) 5 *Current Issues in Criminal Justice,* 244, 251.

g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

(g)(1) Recent legal changes in the United States

Designing an effective mandatory framework for integration of non-shareholder interests in into corporate decision making will be a difficult task. One model that has recently emerged in response to corporate failures in the USA is the new disclosure requirements under section 404 of the *Sarbanes-Oxley Act* of 2002. Under these new rules, a company is required to disclose annually whether the company has adopted a code of ethics for the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. If it has not, the company will be required to explain why it has not.[126]

These new provisions appear to give statutory form to the "if not, why not?" approach to improving corporate governance practices embodied in the Australian Stock Exchange's *Principles of Good Corporate Governance and Best Practice Recommendation*.[127] The operation of the *Sarbanes-Oxley* provisions, and the extent to which they are enforced by regulatory bodies in the USA, should be closely monitored by Australian observers to determine their effectiveness as a mechanism for safeguarding stakeholder interests. A more appropriate measure could be to mandate not only the adoption and disclosure of a code of ethics, but also an obligation that the code would be taken into account in corporate decision making.

(g)(2) Current and proposed legislation in the United Kingdom

In the UK, corporations legislation currently requires directors, in carrying out their functions, to have regard to the interests of employees as well as those of the company's shareholders.[128] The real value of this provision for employees has been questioned, on the grounds that it only requires employee interests to be *considered* (not that they be given priority); and because the duty is owed to the company, and therefore is enforceable only at the instance of shareholders.[129]

Legislative proposals currently under consideration in the UK would see this provision replaced with a more general duty on directors – in acting in good faith to

[126] See further J O'Brien, 'Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets' in J O'Brien (ed), 'Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets' (2005) 1, 17.

[127] For detailed discussion see R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005), para [7.660].

[128] *Companies Act 1985* (UK), section 309(1); see C Villiers, 'Section 309 of the Companies Act 1985: Is it Time for a Reappraisal?', in H Collins, P Davies and R Rideout (eds), *Legal Regulation of the Employment Relation* (2000) 593.

[129] See eg Villiers, above n 128, 595-597; Lord Wedderburn, 'Employees, Partnership and Company Law' (2002) 31 *Industrial Law Journal* 99, 106-108.

promote the success of the company and for the benefit of its members as a whole – to consider a wide range of interests; specifically, those of the company's employees, suppliers and customers; the impact of the company's operations on the community and the environment; and the company's need to maintain high standards of business conduct.[130] Clearly, the final formulation of this duty and its operation under UK law will hold important implications for the adoption of similarly-styled legal duties on company directors in Australia.

[130] Department of Trade and Industry, *Company Law Reform White Paper* (March 2005), 20-21.

ABOUT THE CONTRIBUTORS

Helen Anderson

Helen Anderson PhD is a Senior Lecturer and Acting Head, Department of Business Law and Taxation, Monash University. Her PhD examined the issues of consistency and fairness in the law relating to directors' liabilities to creditors, and it argued that the most vulnerable creditors, especially tort victims, should have rights of recovery against directors.

Paula Darvas

Paula Darvas is a Lecturer in the Department of Business Law and Taxation, Faculty of Business and Economics, Monash University. She has spent time in private practice and also in the Centre for Employment and Labour Relations Law at Melbourne University. Her research interest lies in the intersections between corporate law and labour law, and in traversing the 'logic and limits' of corporate law.

Anthony Forsyth

Dr Anthony Forsyth is a Senior Lecturer in the Department of Business Law and Taxation, Monash University. His PhD explored the potential for Australian adoption of European-style laws requiring employers to inform and consult with workers about major business restructuring decisions, such as mergers, closures and redundancies. He is currently undertaking post-doctoral research on the connection between legal regulation and the adoption of innovative, high performance work practices and "partnership" strategies in modern business organisations.

Wayne Gumley

Wayne Gumley is a Senior Lecturer in the Department of Business Law and Taxation, Monash University. Currently, his main teaching responsibilities are Environmental Law for Business, Corporate Environmental Responsibility, and Risk Control and the Law. Wayne’s research interests are administrative law, taxation policy, environmental law and corporate environmental responsibility. He is currently enrolled in a doctoral thesis which examines the environmental effects of perverse subsidies. Wayne is a member of the National Environmental Law Association (NELA) and is currently the National Editor of the NELA journal, the National Environmental Law Review.

Michelle Welsh

Michelle Welsh is a Lecturer in the Department of Business Law and Taxation, Monash University and a PhD student at the Melbourne University Law School. Her PhD examines the Australian Securities and Investment Commission's use of the civil penalty provisions contained in Part 9.4B of the *Corporations Act*.

Corporate Social Responsibility and the *Corporations Act 2001*

A submission to the Parliamentary Joint Committee on Corporations and Financial Services ('Committee')

30 September 2005

Sam Ure
Secondee Solicitor
Public Interest Law Clearing House (Vic) Inc
Level 1, 550 Lonsdale Street
Melbourne VIC 3000
P: (03) 9225 6682
F: (03) 9225 6686
E: secondee1.pilch@vicbar.com.au

Tabitha Lovett
PILCH Manager
Public Interest Law Clearing House
Level 1, 550 Lonsdale Street
Melbourne VIC 3000
(03) 9225 6690
(03) 9225 6686
manager.pilch@vicbar.com.au

Table of Contents

1. SUMMARY....4

1.1 About PILCH....4

1.2 Overview....4

1.3 Recommendations....4

2. DEFINING CSR....6

2.1 Levels of CSR....6

2.2 Compliance....6

2.3 Sustainability....7

2.4 Responsibility to stakeholders....7

2.5 Philanthropy and social activism....8

2.6 PILCH's observations in relation to CSR....8

3. THE INQUIRY'S TERMS OF REFERENCE....9

3.1 What is under consideration?....9

3.2 Why look at the Corporations Act 2001?....9

4. A NEW FORMULA FOR DIRECTORS' DUTIES....10

4.1 The current formula for directors' duties....10

4.2 How should directors' duties be defined?....11

5. CORPORATE CODES OF CONDUCT....13

5.1 Codes of conduct....13

5.2 International application of a code of conduct....14

5.3 Encouraging the adoption of codes of conduct....15

5.4 The content of a code of conduct....18

6. CSR REPORTING AND DISCLOSURE....19

6.1 Current disclosure requirements....19

6.2 How could CSR disclosure be strengthened?....20

7. SHAREHOLDERS' CSR EXPECTATIONS....23

7.1 Shareholder activism 23

7.2 Empowering indirect shareholders 24

8. CSR IN PROCUREMENT OF GOODS AND SERVICES 24

1. Summary

1.1 About PILCH

The Public Interest Law Clearing House (Vic) Inc ('**PILCH**') is a non-profit, independent legal service based in Melbourne. PILCH co-ordinates the provision of pro bono (without fee) legal assistance to non-profit and community organizations and to marginalized and disadvantaged individuals and groups across Victoria.

PILCH is associated with the Public Interest Law Clearing House Inc of New South Wales, and the Queensland Public Interest Law Clearing House,.

1.2 Overview

This paper discusses various concepts of corporate social responsibility ('**CSR**') and the current legal framework as it relates to CSR and discusses ways in which the law might be changed to encourage CSR. The paper uses the following questions as a basis for discussion of areas in which CSR might be encouraged:

(a) Should the current formulation of directors' duties be restated to encourage directors to take into account a broader set of interests when making corporate decisions?

(b) What other corporate governance measures should be adopted to encourage CSR?

(c) Should companies be required to report on their CSR performance? If so, what information should the reporting contain, and what form should it take?

(d) How could institutional shareholders be required to respond to the CSR demands of indirect shareholders?

(e) Should the Government impose CSR standards upon companies providing goods and services to Government?

1.3 Recommendations

PILCH makes the following recommendations to the Committee:

(a) Recommendation 1

The Committee should consider CSR broadly and look both at:

- decision-making that has regard to the interests of stakeholders other than shareholders; and
- acts of corporate philanthropy and social activism.

The Committee should be wary of considering corporate social responsibility to be limited to acts of philanthropy by companies. Although the Committee should acknowledge and encourage corporate philanthropy, the Committee should also consider ways it can encourage companies to take sustainability and social responsibility into account in their business and operational decision-making.

(b) Recommendation 2

The Committee should not view corporate social responsibility as a substitute for:

- appropriate legislation regulating companies' environmental and social performance; or
- the provision of adequately funded social services through government and not-for-profit providers.

(c) Recommendation 3

The formulation of directors' duties should be amended to follow the model used in the *Company Law Reform Bill 2005* (UK), which requires directors to consider interests other than the interests of shareholders where relevant and so far as reasonably practicable. A draft amendment to the *Corporations Act 2001* is set out at page 13.

(d) Recommendation 4

The Committee should encourage companies to adopt codes of conduct, containing statements of principle intended to govern the conduct of their affairs at all levels of decision-making. Companies' codes of conduct should apply equally to their Australian and overseas operations and should be backed up with appropriate internal compliance mechanisms.

(e) Recommendation 5

Companies should be encouraged to adopt a code of conduct by the introduction of a requirement that they disclose publicly their code of conduct, or disclose publicly their reasons for not adopting a code of conduct ('**comply or explain requirement**').

The comply or explain requirement should apply to all public companies and large proprietary companies, as those terms are defined in sections 9 and 45A(3) of the *Corporations Act 2001*. Draft amendments to the *Corporations Act 2001* are set out at page 17.

(f) Recommendation 6

Companies should be encouraged to refer to and use the UN Norms as a model when drafting their codes of conduct. A definition of 'code of conduct' for the *Corporations Act 2001* is set out at page 19.

(g) Recommendation 7

Public companies and large proprietary companies should be required to disclose all internal policies, manuals and other documents relating to their CSR performance on their website. Draft amendments to the *Corporations Act 2001* are set out at page 22.

(h) Recommendation 8

In addition to existing continuous disclosure obligations, listed companies should be required to make immediate disclosure of events having a material effect on the company's CSR performance.

(i) Recommendation 9

Public companies and large proprietary companies should be required to report, in their annual report, using the GRI Guidelines. Draft amendments to the *Corporations Act 2001* are set out at page 22.

(j) Recommendation 10

The 5% or 100 shareholder rule in s249D of the *Corporations Act 2001* should be retained as a mechanism by which shareholders are able to place resolutions before general meetings relating to the company's social and environmental performance.

The Committee should consider other mechanisms by which companies can be made more responsive to the demands of shareholders in relation to social and environmental performance.

(k) Recommendation 11

The Committee should consider ways in which superannuation funds, financial institutions and other large institutional shareholders can inform retail investors of any ethical, social and environmental principles that will be used to make investment decisions. In doing so, the Committee should have regard to the need for such information to be presented in an accessible way to enable retail investors to readily compare funds' policies with one another.

(l) Recommendation 12

The Commonwealth Government should introduce a policy of procuring only from companies whose CSR performance meets defined benchmarks.

2. Defining CSR

2.1 Levels of CSR

The term ‘corporate social responsibility’ is used broadly to describe a view of corporate governance which advocates the pursuit by companies of a broader range of objectives than simple profit-making. However, it is helpful to distinguish levels of corporate conduct that may be consistent with CSR.[1]

2.2 Compliance

Companies, like individuals, are subject to a wide range of legal obligations and regulation, some of them specific to business and industry sectors (for example, accounting regulations or product labelling requirements) and some of general application (for example, a duty to avoid injury to members of the public). On a conventional economic view, legal compliance might be seen as one of a number of costs to a business. On this view, it is in a company's best interests to adopt a narrow, minimalist view of its legal obligations, so as to limit costs whilst continuing to operate lawfully.

[1] Therese Wilson, 'The "best interests of the company" and corporate social responsibility', paper presented at the Corporate Law Teachers Association conference, 7 February 2005, 4.

Although compliance with all applicable legal and regulatory obligations is fundamental to the practice of CSR, CSR goes beyond compliance in that it involves companies engaging in conduct not necessarily required by law which serves broader interests than the pursuit of immediate profit for shareholders. PILCH considers that corporate governance rules can be changed to promote a culture of corporate decision-making that goes beyond mere compliance and considers the long-term effects of a company's conduct, having regard to a range of external interests.

2.3 Sustainability

Companies are increasingly recognizing that their long-term profitability depends upon their business operations being sustainable. By most definitions, 'sustainability' means that a company must not only take care of operating factors that contribute to its short-term profitability, but do so in a way that preserves its ability to meet future needs, by taking into account social and environmental factors.[2]

In order to sustain its operations over the long term a company is not only required to manage risk and consider its direct operational needs in the future, but also to consider the well-being of the society and environment in which it operates. By taking account of its impact upon and relationship with society and the environment, a company can help preserve and enhance the 'external' conditions that are fundamental to its profitability, such as the natural resources, infrastructure, rule of law and intellectual capital from which it benefits.

2.4 Responsibility to stakeholders

The pursuit of sustainability will require a company to consider a variety of interests, including the interests of 'stakeholders' that are important to its long-term profitability. However, CSR might be said to go further than sustainability in that, by its terms, it suggests a company has a 'responsibility' to take into account the interests of stakeholders, as well as its shareholders. In this vein, Don Argus, Chairman of BHP Billiton Limited, has stated that a company's 'licence to operate' is conferred upon it by the communities in which it operates.[3]

Who are the stakeholders to whom a company owes responsibilities? Stakeholders might be limited to groups connected to the company by conventional legal relationships such as employees, suppliers, clients, and consumers or persons to whom a company owes a duty of care. Alternatively a company might view itself as having responsibilities to a broader group, whose interests are somehow affected by the company's operations, for example as a result of their involvement in secondary or service industries, as a result of effects on a shared environment or as beneficiaries of a social service provided by a private sector operator.

[2] See Sustainable Measures, *Definitions of Sustainability and Sustainable Development* at <www.sustainablemeasures.com/Sustainability/DefinitionsDevelopment.html>.

[3] Don Argus, address to Edmund Rice Business Ethics Initiative, 19 May 2002, at <www.erc.org.au/busethics/articles/1036114283.shtml>.

2.5 Philanthropy and social activism

At its highest level, CSR might include the pursuit, by a company, of objects beneficial to society that are altogether unconnected to its commercial operations. Examples might include acts such as the making of donations to charitable organizations, allocation of staff or other resources to not-for-profit projects or companies taking a public stance on social issues.[4] Advocates of CSR frequently refer to the 'business case' for companies engaging in social activism. Nevertheless, there is no reason why CSR theory should not accommodate the possibility of acts of corporate philanthropy or idealism that have purely altruistic motives.

There are numerous laudable examples of companies engaging in philanthropic projects. PILCH itself could not operate without the support of the private legal profession. However, the generosity of the private sector does not excuse governments of their obligations to meet international human rights standards or to properly fund adequate social services. Companies are rightly discerning in their philanthropy. Their decisions about who to fund, understandably, will be influenced by the sympathies of directors, and the perceived consistency between the objectives of the organisation receiving the support and the values of the donor company.

Increasing not-for-profit organisations' dependency upon corporate philanthropy may result in an ad hoc patchwork of funding that favours not-for-profit organisations with 'acceptable', uncontroversial objectives. Organisations dealing with stigmatised or ethically complex issues need to be assured that governments will continue to provide adequate funding. At the same time, more established not-for-profit organisations could provide higher levels of service delivery for each dollar of funding if they were able to divert resources away from marketing activities designed to attract private sector assistance.

2.6 PILCH's observations in relation to CSR

PILCH acknowledges the significant capacity for companies and other businesses to have a real effect upon social and environmental interests. At the same time PILCH considers that governments bear the primary responsibility for ensuring that companies' conduct is consistent with their desired social and environmental standards and outcomes. Where Australian society determines that particular standards of conduct are expected, in order to protect environmental or social interests, Parliament should give clear expression to those standards in appropriate legislation, and not rely upon the discretion of company directors to make decisions consistent with those standards.

Australian companies, for their part, should adhere to the standards expected of them by the Australian community, both by way of compliance with applicable law and regulations, and by informing their decision-making with general principles consistent with the spirit of those standards. The standards should be the minimum applied to operations overseas as well as in Australia.

[4] An example (albeit short-lived) was Microsoft Corporation's support for a bill banning discrimination against same-sex attracted people (see David A Vise, 'Microsoft Draws Fire for Shift on Gay Rights Bill' *The Washington Post*, 26 April 2005, at <www.washingtonpost.com/wp-dyn/content/article/2005/04/25/AR2005042501266.html>).

Recommendation 1

The Committee should adopt a broad definition of corporate social responsibility incorporating:

- decision-making that has regard to the interests of stakeholders other than shareholders; and
- acts of corporate philanthropy and social activism.

The Committee should be wary of considering corporate social responsibility to be limited to acts of philanthropy by companies. Although the Committee should acknowledge and encourage corporate philanthropy, the Committee should also consider ways it can encourage companies to take sustainability and social responsibility into account in their business and operational decision-making.

Recommendation 2

The Committee should not view corporate social responsibility as a substitute for:

- appropriate legislation regulating companies' environmental and social performance; or
- the provision of adequately funded social services through government and not-for-profit providers.

3. The Inquiry's Terms of Reference

3.1 What is under consideration?

The Inquiry's Terms of Reference ask the Committee to consider revisions both to:

- the legal framework; and
- particularly … to the *Corporations Act 2001*

and invites the Committee 'to have regard to obligations that exist in laws other than the *Corporations Act 2001*'.[5] Despite the breadth of the phrase 'the legal framework', PILCH assumes that the Committee intends to focus on corporate governance, and the *Corporations Act 2001*.

3.2 Why look at the Corporations Act 2001?

PILCH considers that reform to the *Corporations Act 2001* is only one of a number of ways the Government can legislate to improve the environmental and social aspects of corporate conduct. A vast number of other laws (for example, planning laws, consumer protection laws, environmental protection laws, workplace relations laws) regulate companies' interaction with stakeholders in both the narrow and broad groups identified above. However, PILCH acknowledges that most of these laws fall

[5] This is in contrast to the earlier reference to CAMAC (see above n 1) which appeared to be limited in scope to revision of the Corporations Act.

outside the scope of the Inquiry and, on that basis, proposes to deal only with amendments to the *Corporations Act 2001* and the corporate governance framework more generally in this submission.

The *Corporations Act 2001* is relevant to CSR because it sets up the governance framework for companies. The *Corporations Act 2001* makes directors accountable to the company and, indirectly, to shareholders, for their decisions. The question raised by advocates of CSR is whether corporate governance rules should not also make directors accountable for the impact of a company's activities on a broader set of interests.

4. A New Formula for Directors' Duties

4.1 The current formula for directors' duties

Section 181 of the *Corporations Act 2001* provides that directors and officers of a corporation must exercise their powers and discharge their duties:

- in good faith in the best interests of the corporation; and
- for a proper purpose.

The conventional interpretation of the phrase 'the best interests of the corporation' is a narrow one in that the scope of interests that may be taken into account is limited to the interests of the company's shareholders taken collectively.[6]

Accordingly, directors will be acting in breach of their duties unless they are satisfied that a decision that advances the interests of groups other than shareholders is ultimately in shareholders' best interests.[7] In many cases, a decision of this type will be uncontroversial, such as a decision to offer generous conditions to attract and motivate employees or to improve environmental practices to avoid adverse publicity. This means it is at least arguable that 'sustainable' decision-making is consistent with the current formulation of directors' duties in the *Corporations Act 2001.*

Difficulty arises under the *Corporations Act 2001* where directors contemplate conduct not required by law that favours broader community interests, where doing so may have an adverse effect upon shareholders' financial interests.

Example: the James Hardie group restructure

The restructure of the James Hardie group was the subject of the Jackson judicial inquiry in New South Wales in 2004. One of the corporate entities in the James Hardie group had potentially very large liabilities to compensate sufferers of asbestos-related medical conditions, because of its history as a manufacturer of asbestos products. The board of James Hardie Industries Limited approved a series of intra-group transactions the effect of which was to separate and insulate

[6] Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005), [8.095]. An exception to this is that directors have been found to owe duties to creditors in circumstances where a company is insolvent or is facing insolvency (ibid, [8.100]).

[7] *Woolworths v Kelly* (1990) 4 ACSR 431.

the parent company from the former asbestos-producing subsidiary.

The Jackson report found that as a result of the transactions, the subsidiary was left with insufficient funds to compensate sufferers of asbestos-related conditions. But the report found the transactions did not amount to a breach of director's duties,[8] and that there was no legal obligation for James Hardie Industries Limited to provide greater funding to the subsidiary.[9] The directors would therefore be taken to have acted consistently with their duties to protect shareholders' interests. In March 2005, the chairwoman of James Hardie, Meredith Hellicar, publicly called for an extension of directors' duties under the *Corporations Act 2001* to protect decisions taking into account broader stakeholder interests.[10]

The decision to commence an inquiry into CSR and the *Corporations Act 2001* may be a reaction to complaints from company directors that the existing legal framework is too restrictive, and the perception that company directors, keen to make decisions that take into account broader social interests, are concerned that they are not permitted to do so, if they take a strict view of their directors' duties.

PILCH agrees that directors should be able to make 'socially responsible' decisions without fear of breaching their duties, but considers that a more prescriptive approach should be taken to directors' duties to actively encourage boards to take potential social and environmental impacts into account in their decision making.

4.2 How should directors' duties be defined?

If directors are to be required to take broader interests into account, how should the scope of those broader interests be defined, given the very large group of people who may potentially be affected by a company's business operations? PILCH considers that directors should be required to consider the effects of corporate decisions upon the community and the environment, to the extent that these are directly affected by a company's commercial operations. However, creating an obligation for boards in relation to considerations that companies must take into account may result in a process of 'box ticking' or 'lip service' to stakeholder interests becoming part of directors' routine decision-making. To encourage genuine engagement with CSR, directors' duties should not contain a fixed list of stakeholders to whom a duty is owed, but be designed to force directors to think about the outcomes of the company's operations and consider how these outcomes impact upon the company's broader social responsibilities.

[8] D F Jackson QC, *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation*, (21 September 2004) 15.

[9] Ibid, 8.

[10] Bill Phesant, 'Directors Need a Safe Harbour: Hellicar', *Australian Financial Review*, 17 March 2005, 3.

The UK *Company Law Reform Bill 2005*

The UK Government currently proposes to amend directors' duties to enable what it calls an 'enlightened shareholder value' approach to decision-making.[11] The Company Law Reform Bill 2005 (UK) proposes to introduce a new statutory statement of directors' duties, which provides that directors' basic goal should be the success of the company for the benefit of shareholders, but that directors must take account, 'where relevant and so far as reasonably practicable', of:

(a) both the long and short term consequences of a decision; and

(b) any need of the company to have regard to the interests of its employees, to foster business relationships with suppliers, customers and others; to consider the impact of its operations upon the community and the environment and to maintain a reputation for high standards of business conduct.[12]

PILCH recommends that a new formulation of directors' duties be enacted, following the model used in the *Company Law Reform Bill 2005* (UK). That is, the formula should impose an obligation in general terms to consider impacts 'where relevant and so far as reasonably practicable' and state that directors are to take both a short and a long-term view of the interests of shareholders. The statutory formula could include a non-exhaustive list of interests that directors might consider. However, it is important that the list should not come to be viewed as a checklist of factors directors must demonstrate they have turned their minds to before proceeding with a course of action. For that reason, PILCH favours a formula couched in sufficiently general terms to encourage directors to genuinely consider and take account of the social and environmental impacts of company decisions.

Adopting the formula proposed in the United Kingdom would reduce some of the uncertainty relating to the new formulation of directors' duties by giving Australian company directors the benefit of both Australian and United Kingdom jurisprudence in informing their decision-making.

Recommendation 3

Parliament should enact a new s181A of the *Corporations Act 2001* as follows:

181A Duty to consider non-member interests

In exercising their powers and discharging their duties, directors or other officers of a corporation must, where relevant and so far as reasonably practicable, take account of:

(a) the likely consequences of any business judgement in both the long and short term;

[11] Department of Trade and Industry, *Company Law Reform*, (March 2005) <www.dti.gov.uk/cld/review.htm>, 20.

[12] *Company Law Reform Bill 2005* (UK), B3(3).

(b) the need for the corporation to take account of other interests in addition to those of members, including the need:

(i) to have regard to the interests of its employees;

(ii) to foster its business relationships with suppliers, customers and others;

(iii) to consider the impact of its operations on the community and the environment; and

(iv) to maintain a reputation for high standards of business conduct.

Parliament should also enact the following amendment to s180(3):

After the words 'In this section' add 'and in section 181A'.

5. Corporate Codes of Conduct

5.1 Codes of conduct

Currently, companies listed on the Australian Stock Exchange ('**ASX**') are required to give some thought to considerations of environmental and social responsibility in order to comply with the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations ('**ASX Recommendations**').[13]

To comply with Principles 3 and 10 of the ASX Recommendations, companies must adopt a code of conduct setting out the company's view of its responsibilities to shareholders, clients, customers and consumers, employees, the community and individuals. The code of conduct should be backed up by a system ensuring compliance, and should enable employees to alert management to potential misconduct without fear of retribution.[14] The code of conduct, or a summary of its main provisions, is to be disclosed on the company's website.

The ASX Recommendations are not mandatory, in that the ASX Listing Rules provide that a listed company can either comply with the ASX Recommendations, or explain in its annual report the reason why it has chosen not to comply. Nevertheless, this 'comply or explain' model does require boards to consider CSR issues, even if only to explain why they do not consider them to be important. Further, the emphasis on disclosure of the company's position in relation to the ASX Recommendations enables scrutiny by investors, ratings agencies and analysts.

PILCH considers that the ASX Recommendations are a helpful guide for boards in identifying issues that companies should consider in their decision-making. However, the disclosure obligations imposed upon companies in relation to CSR should be strengthened and made referable to universal standards of measuring conduct. They should also be extended, so that they apply to non-listed companies.

[13] ASX, Listing Rule 4.10.3.

[14] AXS, Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*. March 2003, 60.

5.2 International application of a code of conduct

The *Corporate Code of Conduct Bill 2000*

In 2001, the Committee considered a Bill introduced by the Australian Democrats entitled the Corporate Code of Conduct Bill 2000. The Bill proposed to require companies with operations outside of Australia to:

(a) take reasonable measures to prevent environmental damage;

(b) comply with a number of basic workplace relation standards;

(c) refrain from certain types of discrimination in relation to employment;

(d) observe tax laws in their countries of operation; and

(e) protect consumer health and safety.

The Bill proposed requiring companies to provide a detailed annual report on their compliance with the code of conduct. The Bill would have made the code of conduct enforceable by ASIC, but would also have allowed persons who had suffered loss or damage from the activities of Australian companies overseas to seek injunctions or compensation in the Federal Court of Australia.[15]

The majority of the Committee recommended that the Bill not be passed, saying that it was 'unnecessary and unworkable'.[16] It stated that there was no demonstrated need for the Bill, and raised particular concerns in relation to what it saw as 'paternalistic' attempts to apply Australian standards to companies' overseas operations.[17]

As discussed above, PILCH considers that the general law of Australia is the proper place to prescribe the minimum standards companies should apply to their decision-making in relation to their Australian activities. Nevertheless there are a number of ways in which a code of conduct can be a valuable tool in taking a company beyond mere compliance.

(a) The requirement that a board consider establishing and disclosing a code of conduct causes boards to think about the values and ethical standards they want the company to uphold, and be seen to uphold.

(b) A code of conduct can express general principles that are to inform decision-making at all levels of a company's operations. For example, a code of conduct might include the principle that a company's decisions should be consistent not merely with the letter of the law but also with the spirit of the law.

[15] Parliamentary Joint Standing Committee on Corporations and Financial Services, *Report on the Corporate Code of Conduct Bill 2000* (June 2001), 4-6.

[16] Ibid, 46.

[17] Ibid, 45.

(a) A code of conduct can set higher minimum standards than those prescribed by law in Australia. For example, a code of conduct might provide for certain employee benefits or the company's participation in charity programs not required by law in Australia.

(b) A code of conduct might prescribe minimum standards for the conduct of the company's affairs in countries where the standards of conduct expected by the Australian community are either not reflected in local law, or are not enforced by local authorities. The code of conduct could provide that the code of conduct is not to apply to the extent of any direct inconsistency with local law (as opposed to merely setting a higher standard than local law).

PILCH does not agree with the argument that compliance with a code of conduct as well as with local laws would effectively require companies to comply with two sets of rules, which may not always be consistent.[18] Generally speaking, a code of conduct will comprise broad statements of principle, and will not prescribe standards of conduct with the same degree of specificity as government regulation. However, in the event that a code of conduct provides for a standard of conduct which is different to that required by the law of the place in which the company operates, the higher standard should be applied.

In practice it would be rare for a code of conduct to require a company to contravene a foreign law. However, it is a simple matter for the code of conduct to state that local law is to be complied with to the extent of any inconsistency.

Recommendation 4

The Committee should encourage companies to adopt codes of conduct containing statements of principle intended to govern the conduct of their affairs at all levels of decision-making. Companies' codes of conduct should apply equally to companies' Australian and overseas operations and should be backed up with appropriate internal compliance mechanisms.

5.3 Encouraging the adoption of codes of conduct

If companies are to be encouraged to adopt codes of conduct, how should this be effected? As we have seen above, currently, only companies listed on the ASX are required to adopt a code of conduct (or explain their reasons for not doing so).

(a) Mandatory uniform code of conduct

The Committee has already considered and rejected a Bill for the introduction of a mandatory uniform code of conduct prescribing substantive standards governing companies' operations outside Australia.

[18] See, for example, the Business Council of Australia, cited in Parliamentary Joint Standing Committee on Corporations and Financial Services, *Report on the Corporate Code of Conduct Bill 2000* (June 2001), 13.

The possibility of adopting a mandatory uniform code of conduct for Australian companies deserves close consideration. The introduction of a mandatory uniform code of conduct could entrench a set of core minimum standards referable to an internationally accepted statement of human rights standards, such as the UN Human Rights Norms for Business. If Australia gave legislative force to an international set of standards, it may have the effect of giving momentum to movements to make companies abide by those standards elsewhere.

PILCH acknowledges, however, that the introduction of a uniform code of conduct containing environmental and social standards would be a circuitous way of imposing those standards of conduct upon companies. As stated above, PILCH considers that a more appropriate place for the expression of the standards to be expected of Australian corporations is the law of Australia.

Whilst PILCH considers that a uniform code of conduct for Australian companies operating overseas would have a beneficial effect in countries where the standards set out in the code of conduct are not reflected in local law, or are not enforced, PILCH is aware that the Committee has considered, and rejected, a bill for the introduction of a mandatory universal code of conduct applying to the overseas operations of Australian companies. In light of this fact, and the terms of reference of the present Inquiry, PILCH does not make any specific recommendation in relation to a mandatory code of conduct.

(b) What regulatory mechanism?

The mechanism by which companies are to be encouraged to adopt a code of conduct will be an important factor in creating a culture of corporate social responsibility among decision-makers. For a company's code of conduct to be meaningful, it must be a genuine and considered statement of the company's values and ethical standards. The Committee should therefore seek the regulatory mechanism most likely to encourage engagement with the process by directors.

PILCH considers that a simple legislative requirement that companies adopt a code of conduct may have the effect of producing a 'mere compliance' mindset amongst company decision-makers. A more effective way to encourage companies to adopt genuine, considered positions in relation to the social and environmental responsibilities would be to adopt a 'comply or explain' approach, coupled with comprehensive disclosure and reporting. The subject of disclosure is discussed in greater detail under heading 6 below.

(c) Which companies should adopt codes of conduct?

Presently the requirement that an ASX listed company disclose a code of conduct (or explain why it choses not to do so) is imposed by the ASX Listing Rules. There is no reason why the requirement should be limited to listed companies. All companies have the potential to produce social and environmental effects as a consequence of their operations. However, many small companies lack the resources to attend to disclosure of their position in relation to social and environmental responsibility.

The requirement to adopt and disclose a code of conduct should be extended from all ASX listed companies to all public companies (as defined in s 9 of the *Corporations Act 2001*) and all large proprietary companies (as defined in s 45A(3) of the *Corporations Act 2001*). Companies which do not have the resources or the will to adopt a code of conduct can satisfy the requirement simply by explaining their reasons for not adopting or not disclosing their code of conduct.

By adding a provision relating to a disclosure of codes of conduct in Part 2M.3 of the *Corporations Act 2001*, Parliament could create a disclosure obligation sanctionable by the application of a civil penalty provision in appropriate circumstances.

Recommendation 5

Companies should be encouraged to adopt a code of conduct by the introduction of a requirement that they disclose publicly their code of conduct, or disclose publicly their reasons for not disclosing their code of conduct ('**comply or explain requirement**').

The comply or explain requirement should apply to all public companies and large proprietary companies, as those terms are defined in sections 9 and 45A(3) of the *Corporations Act 2001*.

The *Corporations Act 2001* should be amended by the insertion of a new Division 9 in Part 2M.3 as follows:

Division 9 Code of Conduct

323DB Disclosure of a Code of Conduct

(1) A public company and a large proprietary company must:

(a) adopt a code of conduct; and

(b) make the code of conduct publicly available.

(2) Neither a public company nor a large proprietary company need comply with paragraph (1) if it publishes a statement of its reasons for not complying with paragraph (1).

(3) For the purposes of paragraphs (1) and (2), it is sufficient that a public company or a large proprietary company:

(a) makes its code of conduct, or a statement of reasons under paragraph (2), available for downloading from its website; or

(b) if the company cannot reasonably make its code of conduct available on its website, makes its code of conduct, or a statement of reasons under paragraph (2), available on request free of charge from its registered office.

5.4 The content of a code of conduct

The ASX Recommendations contain a useful list of issues that could be covered by a code of conduct.[19] PILCH endorses the content proposed by the ASX Recommendations for companies with operations within Australia.

However, PILCH views it as appropriate that the code of conduct be referable to international standards. The code of conduct should be required to make reference to the United Nations draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights.

The UN Human Rights Norms for Business

In 2003, the UN Sub-Commission on the Promotion and Protection of Human Rights adopted the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights ('**UN Norms**').[20] The UN Norms are a set of rules for business, derived from existing international treaties and standards, which apply to companies with operations in two or more countries.[21] The UN Norms deal with non-discrimination, protection of civilians and the laws of war, the use of security forces, workers' rights, corruption, consumer protection and human rights, economic, social and cultural rights, environmental protection and indigenous peoples' rights.[22]

The UN Norms are not binding on companies unless Governments legislate to implement them. During consultation in respect of the UN Norms, it was clear that the Australian Government did not support mandatory norms for business, and instead took the position that the responsibility for the implementation of international human rights standards rests primarily with States and not business.[23]

Further information: www.ohchr.org/english/issues/globalization/business/

[19] ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (March 2003) Box 10.1, p 60.

[20] UN Doc E/CN.4/Sub/2/2003/38/Rev.2 (2003).

[21] Their application extends to other business enterprises that have relations with transnational companies, or whose activities are not entirely local (Article 21).

[22] Amnesty International, *The UN Human Rights Norms for Business: Towards Legal Accountability* (Amnesty International Publications, 2004).

[23] Australian Permanent Mission to the UN, *Comments by Australia in respect of the report requested from the Office of the High Commission for Human Rights by the Commission on Human Rights in its decision 2004-116 of 20 April 2004 on existing initiatives and standards relating to the responsibility of transnational corporations and related business enterprises with regard to human rights* (8 September 2004).

Recommendation 6

Transnational companies should be encouraged to refer to and use the UN Norms as a model when drafting their codes of conduct.

Code of conduct should be defined in s9 of the *Corporations Act 2001* as follows:

> ***code of conduct*** means a document stating the principles guiding decision making in the conduct of the affairs of the company. A code of conduct may include:
>
> (a) a statement of commitment to the code of conduct by the directors and officers of the company;
>
> (b) a statement of the company's view of its responsibilities to shareholders and the financial community;
>
> (c) a statement of the company's view of its responsibilities to clients, customers and consumers;
>
> (d) a statement of the company's employment and workplace relations practices;
>
> (e) a statement of the company's view of its obligations relative to fair trading and dealing;
>
> (f) a statement of the company's view of its responsibilities to the community and to the environment;
>
> (g) a statement of the company's view of its responsibilities to the individual;
>
> (h) a description of the company's systems for compliance with legal and regulatory obligations affecting its operations in Australia and overseas;
>
> (i) a description of the company's systems for compliance with the code of conduct; and
>
> (j) a summary of the differences between the standards of conduct in the code of conduct and the standards set in the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights published by the United Nations Sub-Commission on the Promotion and Protection of Human Rights.

6. CSR Reporting and Disclosure

6.1 Current disclosure requirements

Companies must make public disclosure in relation to a number of matters, both under the *Corporations Act 2001* and, if they are a listed company, under the ASX Listing Rules. Disclosure of this type is currently made in a company's annual report, on its website or in releases to the ASX under 'continuous disclosure' provisions.

Currently, matters of potential relevance to an assessment of the company's social responsibility are largely absent from the reporting requirements for a company's annual report, which is mostly concerned with the company's financial performance, shareholding and governance structure. Two possible exceptions are the requirement that a company disclose likely developments in its operations in future financial years and details of its performance in relation to environmental regulation.[24]

Companies listed on the ASX are subject to an obligation of continuous disclosure. Broadly speaking, the company must immediately tell the ASX once it becomes aware of any information that a reasonable person would expect to have a material effect on the price or value of its shares.[25] In practice this has required companies to disclose a broad range of matters, including some matters which have a bearing on the company's social responsibilities.

The CSR performance of companies is increasingly the subject of scrutiny by CSR monitoring agencies. Key drivers of the trend of social responsibility monitoring appear to be an increasing recognition of the importance of sustainable business management in creating long-term value for shareholders, and increased investor awareness of the social and environmental impact connected with the use of their funds.

However, effective monitoring of companies' CSR performance depends upon the availability and reliability of the information used to assess that performance. Whilst the *Corporations Act 2001* and the ASX Recommendations require a limited amount of disclosure relevant to CSR to be made in a company's annual report and on its website, the disclosure requirements are not of universal application, and do not enable a comprehensive assessment of companies' CSR performance.

6.2 How could CSR disclosure be strengthened?

CSR reporting should be the principal means by which CSR is encouraged among Australian companies. The reporting and disclosure regime should be designed to promote transparency and timely disclosure of key events and to facilitate ready comparison of companies' CSR performance.

(a) Transparency

Whenever possible, companies should be required to make their policies in relation to dealings with stakeholders and the environment available on their websites.

Currently, companies are required to disclose their code of conduct and the charters governing the operation of their board and board committees, or a summary of the key provisions of these documents, by the ASX Recommendations.

These requirements could be substantially strengthened to require companies to companies to disclose information enabling third parties to conduct a more in-depth evaluation of a company's CSR performance. Companies should be required to disclose all polices relating to their dealing with stakeholders and the environment.

[24] *Corporations Act 2001* (Cth) ss 299(1)(e), 299(1)(f).

[25] ASX, Listing Rule 3.1.

Relevant documents would include:

(i) human resources manuals and equivalent policies and procedures;

(ii) occupational health and safety manuals and policies;

(iii) environmental management systems documents;

(iv) privacy policies;

(v) debt collection and hardship policies;

(vi) ethical procurement policies; and

(vii) customer satisfaction and complaints handling and dispute resolution policies.

(b) Timely disclosure of material events

The obligation in the ASX Listing Rules that a Listed Company disclose events expected to have a material effect upon share price should be extended to apply to events having a material effect upon a company's CSR performance. In particular, companies should disclose events involving breaches of the company's code of conduct.

(c) Enabling comparison of CSR performance

Australian companies should be required to address a universal set of CSR criteria in their annual reporting, to enable investors and ratings agencies to easily compare their CSR performance with their peers. To the extent possible, the reporting should be made referable to international standards.

Example: the Global Reporting Initiative

The Global Reporting Initiative ('**GRI**') is an international organization that produces globally applicable Sustainability Reporting Guidelines ('**Guidelines**'). The Guidelines are intended to complement conventional financial reporting by requiring companies to report annually on economic, environmental and social impacts of their activities. Reporting under the Guidelines is voluntary. Australian listed companies that report under the Guidelines include Rio Tinto Limited, BHP Billiton Limited, Insurance Australia Group Limited and Westpac Banking Corporation Limited.

Further information: www.globalreporting.org

Recommendation 7

Public companies and large proprietary companies should be required to disclose all internal policies, manuals and other documents relating to their CSR performance on their website.

The *Corporations Act 2001* should be amended by the addition of a new section in the proposed Division 9 of Part 2M.3 as follows:

s323DC Disclosure of Corporate Policies

(1) A public company and a large proprietary company must make publicly available all policies, manuals and other statements of the company's practices that the company considers relevant to the discharge of its responsibilities pursuant to its code of conduct.

(2) Neither a public company nor a large proprietary company need comply with paragraph (1) if it publishes a statement of its reasons for not complying with paragraph (1).

(3) For the purposes of paragraphs (1) and (2), it is sufficient that a public company or a large proprietary company:

(a) makes the documents referred to in paragraph (1), or a statement of reasons under paragraph (2), available for downloading from its website; or

(b) if the company cannot reasonably make the documents referred to in paragraph (1), or a statement of reasons under paragraph 2, available on its website, makes its code of conduct, or a statement of reasons under paragraph (2), available on request free of charge from its registered office.

Recommendation 8

In addition to existing continuous disclosure obligations, listed companies should be required to make immediate disclosure of events having a material effect on the company's CSR performance.

Recommendation 9

Public companies and large proprietary companies should be required to report, in their annual report, using the GRI Guidelines. The *Corporations Act 2001* should be amended by the insertion of a new paragraph in section 299 (which deals with the information to be set out in the Annual Directors' Report) as follows:

299(4) Sustainability Reporting

A public company or a large proprietary company must provide a report relating to sustainability and corporate social responsibility consistent with guidelines prescribed by the Minister.

The proposed section 299(4) above is designed to permit the Government to make regulations specifying the relevant GRI Guidelines under which companies' sustainability and social responsibility reporting is to be made.

7. Shareholders' CSR Expectations

7.1 Shareholder activism

Under the *Corporations Act 2001* a company's shareholders can requisition a general meeting, and can have a resolution put before that meeting, or another general meeting, if they control 5% of the votes that may be cast at a general meeting, or the request comes from 100 shareholders entitled to vote at a general meeting.[26] A meeting cannot be requisitioned in this way for the purposes of considering a resolution that is solely within the authority of directors.[27]

The 100 shareholder rule has come under scrutiny in recent years. As well as being used by environmental groups to place resolutions before company meetings, it has attracted negative attention after groups contesting NRMA board elections used it to force 12 extraordinary general meetings of the company over a 2 year period.[28] The Government attempted to remove the 100 shareholder rule for public companies by regulation in 2000, and by a bill amending the *Corporations Act 2001* in 2002. Both attempts were blocked by the Senate.[29]

Another way of gaining the attention of the general meeting of a listed company is to nominate as a director, although some company constitutions require a minimum shareholding in order to nominate.[30]

PILCH considers that it is appropriate and desirable for shareholders to have a mechanism by which to raise issues relating to the social and environmental responsibility of the company of which they are shareholders. A minority of shareholders does not currently have the power to requisition a meeting to discuss resolutions relating to social and environmental performance, nor should they have such a power. However, if Australian companies are to be encouraged to make socially responsible decisions, they should be required to acknowledge shareholders' concerns and account to shareholders in relation to the social and environmental performance.

Recommendation 10

The 5% or 100 shareholder rule in s249D of the *Corporations Act 2001* should be retained as a mechanism by which shareholders are able to place resolutions before general meetings relating to the company's social and environmental performance.

[26] Section 249D.

[27] Ford, Austin & Ramsay, above note 9, [7.410].

[28] Labor Council of NSW 'New Bid to Block Shareholder Pests' *Bosswatch*, 4 December 2004 <bosswatch.labor.net.au/news/general/1038974183_2686.php>

[29] Ford, Austin & Ramsay, above note 9, [7.410]; Cosima Marriner & Anne Lampe, 'Shareholder Pest Clause Lacks Critical Votes' *Sydney Morning Herald*, 4 December 2002.

[30] ASX Listing Rule 14.3 requires listed entities to accept nominations for directors up to 35 business days from the date of the meeting (or 30 business days in the case of meetings requisitioned by members). For a discussion of this approach, see Stephen Mayne, 'Corporate Law Reform Wishlist', *Crikey!* (10 November 2003) <www.crikey.com.au/articles/2003/11/10-0002.html>.

The Committee should consider other mechanisms by which companies can be made more responsive to the demands of shareholders in relation to social and environmental performance.

7.2 Empowering indirect shareholders

A significant feature of Australia's capital markets is the dominance of institutional investors such as superannuation funds, fund managers and other financial institutions. According to the ASX, in 2000, 38% of adult Australians held shares indirectly, including 13% whose only share ownership was indirect.[31] Although indirect investors' funds represent a significant proportion of the capital on the Australian market, indirect investors do not participate in corporate governance, because the votes attached to their shares are exercised by the managers of their funds.

How to enable indirect shareholders to participate in and influence the CSR values of the companies in which they indirectly invest, is an important issue for the Australian market. As a start, fund managers could be required to disclose the principles upon which they base investment decisions, having reference to CSR objectives. Already, fund managers are creating 'ethical investment' products, and sustainability indices allow investors to track the performance of sustainable investments. However, a challenge for the Australian market is to develop a meaningful disclosure framework enabling retail investors to easily distinguish fund managers on the basis of the CSR values informing the investments they make.

Recommendation 11

The Committee should consider ways in which large institutional shareholders such as superannuation funds and other financial institutions can inform retail investors of any ethical, social and environmental principles that will be used to make investment decisions. In doing so, the Committee should have regard to the need for such information to be presented in an accessible way to enable retail investors to readily compare funds' policies with one another.

8. CSR in Procurement of Goods and Services

In addition to making legislative amendments to encourage CSR in Australian companies, the Government could adopt policies to encourage CSR through its dealings with the private sector. The Government has significant dealings with companies through its procurement of a wide range of goods and services. By imposing a requirement that companies providing goods or services to government and government-owned business enterprises, a significant number of companies could be encouraged to review their CSR performance.

[31] ASX, *2000 Australian Shareownership Study* <www.asx.com.au/about/pdf/ShareownershipSurvey2000.pdf> 6. 'Indirect share ownership' for these purposes does not include shares owned by superannuation funds, other than non-compulsory, personally-managed superannuation funds.

Example: the Victorian Government's Legal Services Contract

The Victorian Government has an arrangement in place to encourage the thirty two law firms who make up its panel of legal services providers to engage in pro bono work. Panel firms commit themselves to providing free legal services of a value equivalent to a set percentage of the fees the firm generates as a result of work for the Government.[32] In the period from July 2002 to December 2003, panel firms provided pro bono legal services with a value of $2.6 million to the disadvantaged, for charitable organisations and public interest groups.[33]

Recommendation 12

The Commonwealth Government should introduce a policy of procuring only from companies whose CSR performance meets defined benchmarks.

[32] Department of Justice, *Policy Guidelines for the delivery of Pro Bono services for an Approved Cause under the Government Legal Services Contract*, at <www.justice.vic.gov.au/CA256902000FE154/Lookup/GLS_PDFs/$file/ProBonoPolicyGuidelinesAmended.pdf>.

[33] Department of Justice, *Government Legal Services Report to the Attorney General* (1 July 2003 – 30 June 2004) at <www.justice.vic.gov.au/CA256902000FE154/Lookup/GLS_PDFs/$file/GovernmentLegalServices_20032004_Annual_Report.pdf>, 13.

EcoSTEPS
Sustainability Partner

Brent Couper
Julian Crawford
Tim Heesh
Carole Young

Philip Barron
Jonathan Biss
Philip Booth
Robert Castleden
Dennis Clarke
Paul Darvodelsky
Kathleen Earle
Joy London
Patrick Longfield
Alexia Miall
St John Miall
Paul Payten
Susan Oliver
Ken Wild

5-7 Werong Avenue
Wentworth Falls NSW 2782

Tel/Fax: +61 2 4757 2700

www.ecosteps.com.au
info@ecosteps.com.au

EcoSTEPS Pty Ltd
ABN 21 088 755 275

24 February 2006

By email: john.kluver@camac.gov.au

Attention: Mr John Kluver - Executive Director
Corporations and Markets Advisory Committee (CAMAC)
GPO Box 3967
Sydney NSW 2001

Dear CAMAC

CAMAC: CORPORATE SOCIAL RESPONSIBILITY – EcoSTEPS Submission

EcoSTEPS is pleased to take this opportunity to respond to the CAMAC Discussion Paper.

About EcoSTEPS

EcoSTEPS is a multi-disciplinary consultancy which specialises in Sustainability and Triple Bottom Line strategies and practices. EcoSTEPS provides support and advice to a broad range of organisations across all sectors of society. The eighteen-member team is based in Australia and New Zealand with offices in Sydney and New Zealand and associates and connections throughout Australia and the World. www.ecosteps.com.au

EcoSTEPS has particular interest and experience in TBL/Sustainability accounting, reporting and assurance.

General response to issues and questions raised in the Discussion Paper

EcoSTEPS have chosen not to respond in detail to each of the questions and issues raised. This is because there is considerable overlap between the questions and the Discussion Paper itself canvasses the issues fairly comprehensively. Instead, we summarise EcoSTEPS views on the topic as a whole with a view to stimulating further debate in the critical and urgent policy development area.

Sustainability Context

The implicit backdrop for the whole CSR debate is the fact that more than six billion people are competing for scarce resources on a finite earth. This context is not adequately addressed in the Discussion Paper. For example, Ecologically Sustainable Development (ESD) is only mentioned once as a footnote. (ie Page 41). There is no mention of approaches such as The Natural Step and Ecological Footprinting. These are serious omissions.

The paradigm used is the prevailing economic one. This is myopic and limiting. The CSR debate is global. It must be couched and responded to in global terms.

Further, the concept of 'Corporate Social Responsibility' is merely an interim transition towards the more holistic and comprehensive thinking embraced in the emergent phrase 'Corporate Sustainability Responsibility'.

Triple Bottom Line (TBL)

There is some discussion of TBL but not within the overall sustainability context necessary to give it real meaning. TBL is a useful interim concept as organisations start to appreciate the multi-dimensional nature of sustainability. Work by Forum for the Future in the UK on their Five Capitals model points the direction here. We are facing a sustainability crisis because we're consuming our stocks of natural, human and social capital faster than they are being produced. Unless we control the rate of this consumption, we can't sustain these vital stocks in the long-term.

Regrettably, the essential focus of this Discussion Paper is mostly limited to traditional economic capital and the economic bottom line.

Economic Bottom Line

There are three main problems of the present economic system:

- emphasis on growth;
- neglect of the long term; and
- failure to incorporate the impact on natural systems into how much things cost.

If the present level of consumption is putting unsustainable pressure on natural systems, the situation will get worse if consumption continues to increase. If price signals don't indicate how certain goods and services affect the environment, consumers cannot be blamed for being unable to consider these consequences when deciding how to spend their dollars. Ignoring the long-term implications of our behaviour will lead to disaster. This is the opportunity we need to grasp.

Externalities

The reporting and accountability of CSR issues are at essence about recognition, valuation and reporting of non-traditional financial items, whether these be Intellectual Property, staff turnover, access to clean water or whatever. These so-called 'externalities' are central to the CSR debate. The word is used only once in the Discussion Paper in a footnote (Page 37).

The absence of consideration of 'externalities' and full cost accounting severely limits the range and usefulness of the Discussion Paper.

Stakeholders

The Discussion Paper mentions 'stakeholders' extensively but regrettably fails to mention the draft Stakeholder Engagement Standard from AccountAbility (AA1000SES) which considers the issue extensively. A brief mention of AA1000 is made on Page 10.

Without making substantive progress on developing and articulating a comprehensive and cohesive stakeholder framework, then the existing processes and legislation relating to Shareholders and Corporations are unlikely to progress much.

Decision-making

There is some discussion of decision-making. This is the key issue. “Which stakeholders should be making what decisions and how?”

One definition of ‘sustainability’ developed by EcoSTEPS is: “Sustainability is achieved when all stakeholders optimise decision-making processes that allocate scarce resources over time.”

Global Reporting Initiative (GRI)

As the Discussion Paper mentions, France and South Africa have engaged with GRI at a national level. A significant number of global and Australian companies are now reporting under GRI. It is the de facto global standard. It embraces AA1000 (and its approaches to stakeholder engagement and assurance).

GRI is the leading global sustainability reporting initiative. The Australian Government should mandate GRI reporting for organisations which meet certain materiality thresholds. For example, those exceeding one or more economic, social or environmental thresholds: eg dollar turnover, number of employees, GHG emissions etc).

* * *

EcoSTEPS would welcome the opportunity to discuss any or all of the matters raised in this submission with CAMAC. In the first instance, please contact Julian Crawford on 02 4757 2700 or juliancrawford@ecosteps.com.au

Yours sincerely

Julian Crawford on behalf of EcoSTEPS
Director

CORPORATE SOCIAL RESPONSIBILITY

SUBMISSION TO THE CORPORATIONS AND MARKETS ADVISORY COMMITTEE

STEPHEN EPSTEIN SC

Introduction

1. The Committee has been requested to report on, amongst other things, the desirability of amendments to the Corporations Act, as to the nature and extent of company directors' duties.

2. Consideration is to be given to possible amendments, by which directors could be permitted (or required) to have regard to *"the interests of specific classes of stakeholders or the broader community";* in distinction to the traditional company law formulation of *"bona fide for the benefit of the company as a whole"*. That traditional formulation, in normal circumstances, is directed to the interests of the company's shareholders as a body; obviously being a narrower and better defined constituency than that of *"stakeholders"*.

3. One possible form of amendment to the Corporations Act would involve the adoption of the approach taken by clause 156 of the Company Law Reform Bill 2005 (United Kingdom), in imposing a (limited) duty for directors to have regard to the interests of the company's employees, suppliers, customers, etc.

4. The Advisory Committee's request for submissions on these matters asks that attention be directed to the implementation and operation in practice of any change of this nature, as might be made to the Corporations Act.

5. The perspective from which the writer of this Submission views these questions is from 30 years of legal practice, in particular in litigating many forms of legal proceedings brought under and relating to corporations law issues. It is the writer's firm view that amendments to the Corporations Act, along the lines of the United Kingdom Bill, would not be conducive to the interests of the community as a whole, nor to any particular sector, such as company employees. On the contrary, such a change would, in all likelihood, create obscurity and confusion as to the legal content of company directors' duties, which under the existing law is well understood and satisfactorily defined.

The operation of the existing law in practice

6. The general duties of company directors are now described in Part 2D.1 Division 1, Corporations Act. Those statutory duties, as defined by reference to the phrase *"in good faith in the best interests of the corporation"* reflect the pre-existing general law, which in any event is expressly preserved by s.185.

7. The *"in good faith in the best interests of the corporation"* test was first laid down by the courts in the early development of the limited liability company and has operated satisfactorily ever since the 19th century.

8. The satisfactory working of this fundamental principle of company law is well demonstrated by the apparent absence of any critique or criticism of the application of the existing law to any reported case or specific factual situation. Indeed, it is submitted that, in the whole history of company law, there is yet to occur any reported case which would have been differently decided and with a fairer or better outcome had the traditional legal definition of company directors' duties been other than as it is.

9. The existing law does not prevent or inhibit company directors from proper regard to considerations of corporate social responsibility. The Committee's exposition of the law in section 2.2 of the Discussion Paper demonstrates that this is so. Moreover, even a casual observation of financial and commercial affairs in Australia is enough to show it to be commonplace that corporate decision-making is publicly justified and explained by reference to considerations of corporate social responsibility. It is thus clear that any inhibition to socially responsible action does not rest in the content of the existing law.

Dilution of the *"best interests of the corporation"* test

10. A redefinition of the duties of company directors, along the lines of the United Kingdom Bill, would subvert the law as it operates at present, by removing the simple and objective criterion, against which company directors' performance of their duties can be adjudicated upon.

11. The United Kingdom proposed legislation suffers from obscurity, even as a matter of drafting, in its reference in sub-clause (2) to the undefined concept of *"the purposes of the company ... other than the benefit of its members"*.

12. More fundamentally, a statutory countenancing of an entitlement on the part of directors to pursue policies inconsistent with the economic welfare of the corporation would give free rein to directors to pursue, without legal sanction, almost any policy or action they choose.

13. A dilution of the requirement for directors to act in the best interests of the corporation would have particularly adverse ramifications in the practical operation of company law as it concerns companies in an insolvent or near insolvent condition. The position of unsecured creditors, in particular company employees, is disadvantageous enough under the existing law, as shown through practical experience and also illustrated in a variety of high-profile cases.

14. The problem can be demonstrated by a simple illustration from the case law. An early example of the modern phenomenon of the *"phoenix company"* was considered by McLelland CJ in Eq in Re Yorke (Stationers) Pty Ltd[1]. The

[1] [1965] NSWR 446

plaintiff company was insolvent in consequence of a judgment debt due to its landlord, which debt the company's directors did not feel was morally justifiable. In order to keep the company's business alive, the directors transferred its business to themselves, apparently for fair value, and using the purchase price to discharge the company's obligations to its remaining creditors, being its trade creditors.

15. The directors were held liable in the proceedings brought against them by the company (through its liquidator), upon the basis of their default in exercising their fiduciary powers for the benefit of the company as a whole; in accordance with the general principle stated in Ngurli Limited v McCann[2], etc.

16. In a case such as Re Yorke (Stationers), it is obvious that the actions of the company's directors may be highly beneficial to the interests of stakeholders, being its suppliers and its customers and its employees. Nevertheless, it is appropriate that the law should proscribe such transactions, upon the basis that they are undertaken other than for the benefit of the company as a whole.

17. A change in the law, along the lines of the United Kingdom Bill, would jeopardise this position and would thus be a retrograde step. Sub-clause 156(4) to the United Kingdom Bill does not protect the interests of creditors, since their protection derives from the directors' duty to act in the interests of the company and not from any duty towards the creditors[3]

Corporate governance

18. The ideal of corporate social responsibility is not to be disparaged, forming as it does, an important element in the overall corporate governance issue, being a matter of grave concern in Australia and worldwide.

19. Some people might perhaps think that the insertion into the Corporations Act of a sentiment exhorting the virtues of corporate social responsibility will, in itself, motivate action in that direction. However, in practical experience, company directors are not avid readers of the Corporations Act. It would be naïve in the extreme to think that the mere expression of the sentiment in the Act could be conducive to changed behaviour.

20. If the Corporations Act is to be amended with a view to facilitating the goal of corporate social responsibility, more is necessary than words of exhortation. The creation of legally enforceable rights and obligations would be necessary.

21. If the interests of stakeholders, other than shareholders, are to obtain legal recognition in the Act, then it would be necessary for the Act to lay down procedures whereby such stakeholders can enforce their rights against the company.

22. Thus, if the closure of a company's motor vehicle manufacturing plant, in prejudicing the company's employees, is potentially to be a breach of legal duty

[2] (1953) 90 CLR 425

[3] Spies v R (2000) 201 CLR 603, referred to in footnote no. 109 of the Discussion Paper.

on the part of the company's directors, it would logically be necessary for the Act to make available a cause of action in favour of the employees.

23. Similar cases could be multiplied. Thus, in the case of a bank which closes its country branches, the customers would need to be given a cause of action under the Act. More generalised corporate social responsibility issues, such as environmental issues, would not have any obvious stakeholder representative, so that there would presumably need to be standing given to public interest groups to litigate the making of corporate decisions relevant to such issues.

24. At least in the case of Australian listed public companies and as a practical device, stakeholders could simply acquire a small shareholding in the company and, in the guise of shareholders, litigate corporate decisions not to their liking. It would not be desirable that the Corporations Act facilitate such stratagems. If stakeholders are to be given enforceable rights, those rights should be given to them directly and procedures for their enforcement expressly stated.

25. It is neither practical nor desirable that this should occur. The courts are not well placed to adjudicate upon business decisions, either as to their commercial merits or as to their corporate social responsibility impact.

26. The observations of Kirby P, as he then was, set out in footnote no. 115 of the Committee's Discussion Paper are in point: likewise, see Re Ansett Australia Ltd and Korda[4].

27. Similarly, 200 years ago, the famous Lord Chancellor, Lord Eldon, explained that it was not the role of the Court in the resolution of partnership disputes to do more than require the bringing of the partnership business to an end, since otherwise there would be *"an expectation that this Court is to carry on every brewery and every speculation in the kingdom"*[5]

International considerations

28. A dilution or obscuring of the Corporations Act requirement that directors exercise their powers in the best interests of the corporation would be inconsistent with the general trend internationally in corporate governance.

29. The 2004 OECD Principles of Corporate Governance prescribe as the primary principle for the responsibility of boards of directors that:

> *"Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders."*

30. The Statement on Global Corporate Governance Principles of the International Corporate Governance Network, expounding the OECD Principles, as revised on 8 July 2005, commences:

[4] (2002) 40 ACSR 433

[5] Waters v Taylor (1807) 15 VesJ 10; 33 ER 658 at 664

> *"1.* ***CORPORATE OBJECTIVE – SHAREHOLDER RETURNS***
>
> *1.1* ***Optimising Return To Shareholders.*** *The overriding objective of the corporation should be to optimise over time the return to its shareholders. Corporate governance practices should focus board attention on this objective. In particular, the company should strive to excel in comparison with the specific equity sector peer group benchmark. Where other considerations affect this objective, they should be clearly stated and disclosed.*
>
> *1.2* ***Long Term Prosperity Of The Business****. To achieve this objective, the board should develop and implement a strategy for the corporation which improves the equity value over the long term."*

31. The current provisions of the Corporations Act are consistent with the application of those objectives to Australian corporations. No change to the Corporations Act in this respect is necessary or desirable.

24 February 2006 STEPHEN EPSTEIN SC

Submission to the Corporations and Markets Advisory Committee

Corporate Social Responsibility
Discussion paper
November 2005

Marina Nehme[*]
Address: 102/116 Maroubra Rd,
Maroubra NSW 2035
Email: Marina.Nehme-1@uts.edu.au

Introduction

This submission addresses the release of the CAMAC Corporate Social Responsibility Discussion Paper (November 2005). I have attempted to provide informed debate on the critical issues discussed in the paper. Some of the suggestions made in this submission are of a policy nature and question the need for change.

If further explanation is required, please contact me at: Marina.Nehme-1@uts.edu.au

Explanatory Note

For the sake of clarity and coherency in this submission, parts of the draft discussion paper have been reproduced where necessary.

[*] **NEHME**, Marina is a part time Lecturer in Corporate Law at the University of Technology, Sydney and researcher in corporate law issues.

General Observation

Companies today are put in a difficult position. The public expects companies to be good citizens and investors require companies to concentrate on their bottom line, profit. It is not always possible for everyone to be satisfied with the policies adopted by a company.

For instance, some pharmaceutical companies like Roche, GlaxoSmithKline, Astrazeneca and Bristol Myers Squibb are not drug companies but innovation companies. They invest huge sums of money in the development of new effective drugs and use patents to recoup the cost of that innovation for a limited time before generic manufacturers, who bear none of the costs of research, can move in to copy and produce cheaper versions of those drugs. Without patent protection, those companies cannot innovate. Without new drugs in the pipeline, they will fail.[1]

As long as these pharmaceutical companies have new drugs at their disposal, they will make profits and their shareholders will prosper and be happy. This seems to be an ideal type of business: the new drugs heal people and the shareholders are content because the company is making profits. However, a dilemma is created when we take into consideration the millions of poor people around the world who need the products of this innovation in order to live, but whose governments lack either the means or the will to purchase the required drugs at full price, and the innovation model loses some of its appeal.[2]

For example, with the onset of AIDS as a tragic reality in Africa, these companies found the innovation model fundamentally challenged by a broad mass of the public who, disinclined to dwell on the niceties of pricing policies, rode a wave of moral revulsion that profits could be made from drugs which people needed to live. The industry defended the status quo by noting that companies existed to make profit, and realised only too late that the rules had fundamentally changed. These companies needed to take

[1] Mallen Baker, "If Roche sneezes, the Pharmaceutical Industry catches a cold", 87 *Business Respect* (30 Oct 2005), <http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1507> viewed on 9 February 2006.

[2] Ibid.

into consideration not only their own profit margins but also the impact their actions had on society.[3]

There is a lot of talk today about corporate social responsibility, but it remains a grey area. What exactly is corporate social responsibility, and when does it apply? For instance, we believe that killing people is wrong. This is one of the earliest principles established by any civilized society. So is it possible that a company could be considered socially responsible if its products, used as instructed, result in loss of human life? Immediately the tobacco companies spring to mind. The use of tobacco can result in cancer, yet companies are allowed to sell this product.[4] Are those companies socially responsible?

A discussion of corporate social responsibility is needed. It will encourage companies to look at a range of stakeholder interests, and can push us to understand how the potential risks and opportunities a business faces might be reconciled with the wider social or environmental consequences.[5] The discussion paper, *Corporate Social Responsibility*, November 2005, looks at the debate around corporate social responsibility and the need for development of good corporate social practices through changes in the law.

1. The issue of Corporate Social Responsibility

How might corporate social responsibility usefully be described for working purposes?

For many companies, corporate social responsibility is still a vast and unknown dimension. To determine the meaning of corporate social responsibility, one needs to take into consideration four different levels of corporate social responsibility as indicated in the pyramid below:[6]

[3] Ibid.

[4] Mallen Baker, "Can companies that make products that kill be socially responsible?" 86 *Business Respect* (18 September 2005) <http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1492> viewed on 9 February 2006.

[5] *Corporate Social Responsibility: A Government Update*, p 6 <http://www.societyandbusiness.gov.uk/pdf/dti_csr_final.pdf> viewed on 10 February 2006.

[6] The pyramid is taken from: Thomas Loew, Kathrin Ankele, Sabine Braun and Jens Clausen, "Significance of the CSR debate for sustainability and the requirements for companies" (30 June 2004)

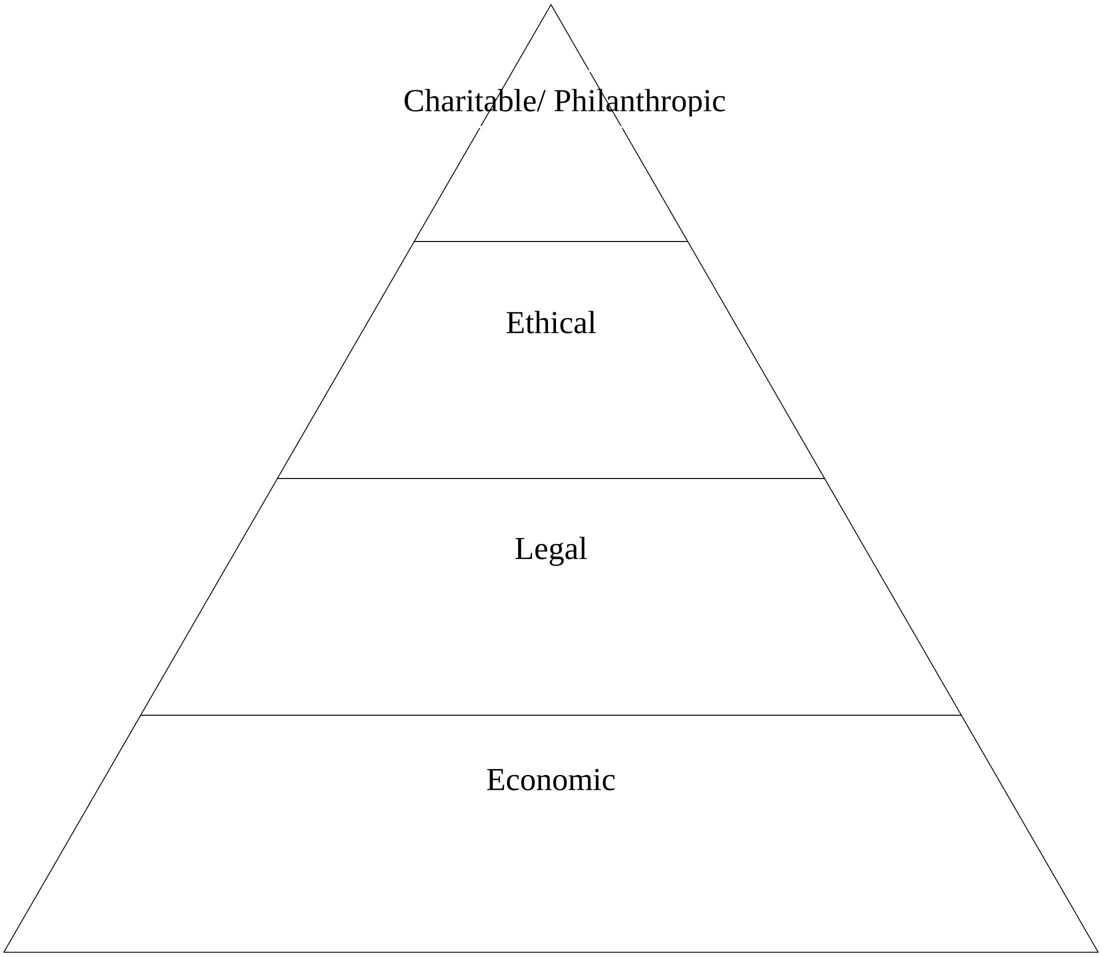

Figure 1: Levels of social responsibility

Some of the levels in the pyramid are mandatory considerations for companies, while others could be said to be merely desirable in a company's behaviour. For instance, a company must make a profit to survive, and every company must obey the law. Economic and legal considerations are therefore essential governors of corporate behaviour. By contrast, there is no mandatory requirement that a company be ethical, yet

< http://www.4sustainability.org/downloads/Loew-etal-2004-CSR-Study-Summary.pdf > viewed on 14 February 2006.

it could be said to be desirable. Similarly, companies are not required to be charitable or good corporate citizens, yet we see these behaviours as desirable. There will necessarily be limits to the application of the top levels (ethical/charitable) of the pyramid to corporate behaviour because a company cannot apply them without taking into consideration the lower two levels (economic/legal). A balance needs to be struck between these elements.

For instance, sponsorship activities and other community programs that benefit companies and hence their shareholders are acceptable. It is not just legitimate for directors and managers to spend money on such activities; it is their duty to do so if it benefits the company. In this case, we could say that such action complies with all four levels of the pyramid. On the other hand, not every charitable action of a company can be applauded. Activities of a purely charitable nature that do not benefit the company as a whole would, as a result, not be legitimate. If a company spent money on a pet charity of the managing director's wife, for example, this would involve a conflict of interest and accordingly breach the legislation unless the company's shareholders had agreed to it.[7]

It is my view that the definition of corporate social responsibility we should adopt is that put forward by Deborah Doane, as this best represents the four levels of the pyramid seen in Figure 1. Corporate social responsibility can thus be seen "as the efforts corporations make above and beyond regulation" (the legal level) "to balance the needs of stakeholders" (charitable/ethical levels) "with the need to make a profit" (the economic level).[8]

[7] New Zealand Business Roundtable, "Making Sense of Corporate Citizenship" (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[8] D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 23.

Which approach or combination of approaches to responsible corporate behaviour is most appropriate?

Are voluntary initiatives sufficient to implement corporate social responsibility or are more drastic measures, such as putting regulation in place, needed? Certain groups such as trade unions and civil society organisations have emphasised that voluntary initiatives are not sufficient to protect workers' and citizens' rights. They believe that a regulatory framework which establishes minimum standards of compliance and ensures a level playing field is the best solution.[9] So should we legislate in relation to corporate social responsibility? Many countries, like France, the United Kingdom and the United States, have done so. In all these instances the legislation when first enacted was heavily criticised for increasing costs for and putting unreasonable expectations on corporations… but was that really true? Table 1 illustrates the difference between what was predicted and the reality in relation to some corporate social responsibility legislation.[10]

[9] Commission of the European Communities, *Corporate Social Responsibility: A Business contribution to Sustainable Development*, (Brussels, 2 July 2002), 4 < http://europa.eu.int/comm/employment_social/soc-dial/csr/csr2002_en.pdf> viewed on 13 February 2006.

[10] This table is taken from the following article: D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 28.

Regulation	Prediction by Business	Reality
National minimum wage	Would result in over 1 million U.K. job losses within two years	Unemployment fell by 200,000
EEC introduction of catalytic converters	The cost of the technology would be £400-£600 per vehicle, with a fuel consumption penalty on top	Real costs of around £30-£50 per converter; technological innovation led to smaller and cheaper cars
US Clean Air Act	Would cost the US $51-$91 billion per year and result in anywhere from 20 000 to 4 million job losses	Yearly cost of $22 billion to business but employment in areas affected up by 22 percent; the benefits arising are between $120-$193 billion
Montreal Protocol	Opposed by industry on economic cost, but no projected figures	No impact; substitute technology may have saved costs, according to follow-up studies

Table 1: Regulation or burden?

This table demonstrates that regulation which imposes mandatory rules on companies to ensure that they behave in a socially responsible manner does have certain benefits. It is quite apparent when looking at Table 1 that the predictions made in relation to the implementation of the legislation were farfetched. It could be argued that legislation is beneficial for it brings with it predictability and innovation. It also has a positive effect on consumers and employment. For example, it can change the way consumers think by making them more aware of the importance of corporate social responsibility. Social labeling laws, for instance, have been an extremely effective tool for changing consumer behaviour in Europe. Following the enactment of legislation, all appliances had to be labeled with an energy efficiency rating. Today, the appliances rated as the most energy efficient capture over 50 percent of the market. Added to that, the standards for the ratings are continuously improving, through a combination of both research and legislation.[11] Minimal regulation such as this can play an educative role and increase the awareness of the public in relation to the issues it deals with.

However, regulation by itself is not enough to implement corporate social responsibility in companies. We also need the involvement of the relevant stakeholders and each company should have a monitoring system in place to ensure that it is properly implementing corporate social responsibility. There is a need to ensure that companies are not simply claiming to be committed to the environment and society in general. We need a system to tell us if companies truly are doing what they say they are doing.

What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

Incentives that will motivate a company to conduct its business in a socially responsible manner include:[12]

- Protecting, building and enhancing reputation: it is very commonly said that corporate social responsibility is good public relations. Companies behave in a socially responsible way in order to protect their reputation, bearing in mind that it takes just a single incident to ruin a perfectly good reputation;
- Reducing costs through eco-efficiency: if doing business in a socially responsible manner reduces the cost of running a business, then companies will usually be motivated to behave in this way;

[11] D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 28.

[12] Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 8, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

- Attracting and retaining skilled and motivated employees: if employees believe that the company cares for them and has the same beliefs as they do, they will be more loyal to the company and will be motivated to perform their jobs to the best of their ability. For instance in the mid-1990s, Shell suffered negative publicity that led to a productivity downturn and a low employee morale. The company's subsequent commitment to collaboration and stakeholder responsiveness turned things around;
- Protecting or enhancing the resources (environmental or human) on which the business depends;
- Anticipating costs (including insurance costs), societal and stakeholder expectations, customer demands, and future legislation;
- Retaining the "license to operate", that is, if there is regulation which demands that companies follow certain rules in relation to corporate social responsibility, companies will follow the legislation at the risk of being penalised and losing their licence to operate;.
- Improving quality and effectiveness;
- Being an attractive prospect for investors: companies are aware that certain investors seek to invest in line with their own values, or in line with an expectation that companies with a socially responsible approach will be better investments;[13]
- Improving relationships with stakeholders;
- Attracting consumers: certain consumers will choose a product or service from one company over another on the basis of their understanding of a company's environmental or social credentials.[14]

[13] See below for more details.

[14] See below for more details.

Similarly, a company might face certain obstacles when trying to adopt socially responsible behaviour:[15]

- Uncertainty about what is involved. Corporate social responsibility is a complex and uncertain notion. It is a vague terminology which everyone has heard of but no one can easily define. There are also unclear parameters that need to be clarified like, for instance, who are the stakeholders? Are they the community at large, or only people directly affected by a company's actions?
- Cost: undertaking to behave in a socially responsible manner involves continuous effort and adaptation. There may be costs, such as the time and investment needed to plan and implement new ways of doing things. Evidence of the benefits of corporate social responsibility is generally poorly available (aside from eco-efficiency benefits) and remains in some cases elusive. A company might well question the wisdom of paying huge amounts of money to implement a system which has only elusive benefits.
- It is costly and time consuming for companies to collect information in relation to their performance and it is even more difficult for the public to ascertain the reliability of such information.
- Directors’ dilemma: are the directors breaching their duties when practicing corporate social responsibility?[16]

Do different or additional implications arise depending on the nature or size of the enterprise?

It is important to note that the implications arising in relation to conducting one's business in a socially responsible manner will vary according to the size, age and activity of the company, and its geographical, political and cultural context. Accordingly, different factors will motivate different companies to take corporate social responsibility on board. What may seem important to one corporation is not necessarily equally

[15] Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 8, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

[16] This point will be developed in part 2 in more detail.

important for all. Some factors will be more relevant to small businesses, and some to larger businesses. It is also the case that something which is seen as an obstacle by one organisation may be seen by other organisations as a driver or a success factor.[17]

A study done in Canada showed that small businesses practise corporate social responsibility often without recognising that they are doing so. Several businesses noted that "they do not consider their practices to be particularly responsible, just good business." For instance, many small and medium companies started their corporate social responsibility efforts with a range of environmental initiatives such as changing the type of paper they purchased. In relation to community engagement, however, the study showed that the small and low profile companies had very few, if any, community initiatives underway. On the other hand, the larger and higher profile companies had stronger links to their community and as a result evidenced more community engagement. [18] This Canadian study clearly shows that when small and medium businesses have the means to practise corporate social responsibility, they do so.

Factors that will be taken into consideration by small and medium companies when implementing corporate social responsibility include:[19]

- Identifying credible tools or practices: each company has different needs, depending on its goals and size. The identification and development of effective and credible tools or practices, which suit the company's particular and changing circumstances, could be difficult because a practice that is relevant for one company may not be for another. In addition, the particular language of corporate

[17] Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

[18] Canadian Business for social responsibility, *Engaging Small Business in Corporate Social Responsibility* (October 2003) < http://www.cbsr.ca/files/ReportsandPapers/EngagingSME_FINAL.pdf> viewed on 16 February 2006.

[19] Ibid and look at Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006 .

social responsibility may need to be adapted and made concrete for small and medium businesses.

- Cost: depending on the size of the company, the cost of implementing socially responsible practices might be crippling. Even if they believe that the company might benefit from it, small and medium companies might lack the skills, resources or experience to implement corporate social responsibility. Other companies might have more pressing concerns, such as competing priorities, to worry about.
- Time: Small and medium businesses might lack the time to identify and engage their stakeholders.
- Sourcing environmentally friendly product can be very hard for small and medium businesses because they rarely have the purchasing power to influence their suppliers to provide them with environmentally and socially responsible products.
- Consumers: a large number of consumers do not make their purchasing decisions based on how environmentally or socially friendly a product is, but on the price of the product for instance. Accordingly, it is not appealing for small businesses to produce products that are more socially and environmentally responsible if no-one will buy them because they are more costly.
- Training of employees: limited resources may make it hard for small and medium companies to implement a proper communication system and the education of their employees on corporate socially responsible practices.

Accordingly, adopting corporate social responsibility is a gradual process for small and medium businesses. We should not impose new rules to force them to comply with corporate social responsibility because the experience in Canada shows that they undertake new socially- and environmentally-friendly activities when it is financially feasible, when time permits and when consumers demand it.

To what extent is corporate decision-making driven by stakeholder concerns?

Can companies satisfy the interests of all stakeholders? The answer to this question can be easily found in past experience.

In the 1970s a number of countries were involved in a push for ‘industrial democracy’, involving workers' representation on company boards and the formation of workers' cooperatives. These experiments ended soon after because they did not work properly. For example, in Sweden after the Second World War there was a desire to ensure democracy for workers and employees. A series of agreements on co-operation, such as the 1970 agreement on the position of the club chairperson within the enterprise and the 1975 agreement between SAF, LO and PTK on economic committees and independent experts, were adopted. None of these agreements, however, resulted in the desired employee representation in the decision-making process and legislation had to be enacted to ensure the protection of employees.[20]

“Stakeholder theory” is another concept that needs to be taken into consideration. When applied to corporations, “stakeholder theory” argues that managers should make decisions by taking into consideration the interests of all the stakeholders in a firm. This situation seems ideal and the perfect solution to a successful application of corporate social responsibility. However, Michael Jensen of the Harvard Business School points out that it is logically impossible to capitalise in more than one direction because the company is ultimately accountable to those who have entrusted their capital to the firm, its shareholders.[21] It is next to impossible to take into consideration the interests of the shareholders, stockholders, wholesalers, sales force, competition, customers, suppliers, managers, employees, and government.[22]

[20] “Industrial Democracy”, < http://www.eurofound.eu.int/emire/SWEDEN/ANCHOR-F-Ouml-RETAGSDEMOKRATI-SE.html > viewed on 16 February 2006.

[21] New Zealand Business Roundtable, “Making Sense of Corporate Citizenship” (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[22] Brenner, S.N., and Cochran, P. 1991 “A stakeholder theory of the firm: Implications for business and society theory and research”. *Proceedings of the International Society for Business and Society*: 449-467.

Experience shows that some of the companies which have attempted to run themselves on stakeholder lines have failed miserably. Under CEO Bob Haas, Levi Strauss attempted to prove that a company driven by social values could outperform one driven by profits. The company involved everybody in decision-making, set up 80 task forces to make the company more "aspirational", promoted diversity, vetted contractors for labour practices and so on – and took its eye off the ball of profitability. Its costs blew out, its market share plummeted, it was forced to lay off 16,000 workers and its market value shrank from US$14 billion to US$8 billion before it was forced to abandon "its failed utopian management experiment."[23]

In the end one can say that corporate decision-making should be driven by stakeholders' concerns as long as those concerns benefit the company and ultimately the shareholders. Companies will try to find a middle ground between the expectations of the shareholders and the expectations of the broader community. Directors are fully aware that their companies' primary mission is to make profits, but they also are under pressure to demonstrate that their businesses have a social conscience. Accordingly, corporate decisions will take into account the following matters (and again these elements represent an application of Figure 1):[24]

- Strong, sustained economic performance: how will a company's decision improve the financial performance of the company?
- Rigorous compliance with financial and legal rules: will the decision of the company breach any legislation?
- Ethical and other citizenship actions, beyond formal requirements, which advance a corporation's reputation and long-term health: how will ethical and charitable decision-making affect the image of the company and in the end its bottom line?

[23] New Zealand Business Roundtable, "Making Sense of Corporate Citizenship" (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[24] "Corporate Social Concerns" <http://online.wsj.com/public/article/SB113355105439712626.html?mod=home_in_depth_reports > viewed on 16 February 2006.

An application of these elements will ensure a balance between the interests of the different stakeholders without having negative repercussions on the profit of the company.

In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company?

Surveys have been done in Canada and the European Union in relation to stakeholders' attitudes toward a company's efforts at social responsibility.

A Conference Board of Canada poll showed that 77% of Canadians are most likely to invest in, 81% to purchase from, and 79% to work for companies they view as socially responsible. Recent Schulich School of Business research also revealed that 9 out of 10 Canadians believe corporate social responsibility should be a top corporate priority and, in fact, should be part of an international Canadian competitive strategy. Accordingly, in Canada, the expectations of stakeholders for corporate behaviour are high. Sixty-six percent of Canadians surveyed want firms to go beyond obeying laws. They want corporations to be fully accountable for any conduct that might undermine social and environmental health.[25]

In 2000, Market and Opinion Research International interviewed 12 000 consumers across 12 European countries on their attitudes towards corporate social responsibility and its application by companies. Seventy percent of European Consumers said that they would take into consideration the company's commitment to social responsibility when buying a product or service, and one in five would be willing to pay more for products that are socially and environmentally responsible.[26]

[25] Susan Flynn, "Winning with Integrity: The Business Case for Corporate Social Responsibility" < http://www.cbsr.ca/files/ReportsandPapers/WinningwithIntegrityAMpdf.pdf > viewed 16 February 2006.

[26] "Stakeholder Dialogue: Consumer attitudes" < http://www.csreurope.org/whatwedo/Stakeholderdialogue/consumerattitudes/ > viewed on 17 February 2006.

Accordingly, it can be seen that some stakeholders will take a company's social responsibility performance into consideration.

2. Directors' duties: current position

Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?

Howard has observed: [27]

> "We seem to have achieved the worst of two worlds; a system of regulation that goes too far while it also does too little."

This observation reflects today's reality. A huge number of regulations and penalties are contained in the *Corporations Act* yet there are still situations that escape regulation. We are considering putting even more regulation in place in an attempt to clarify the law and cover scenarios that escape the current legislation. But before burdening directors with more regulation to force them to take into consideration corporate social responsibility issues we need to answer these two questions:

1. Does the *Corporations Act* allow directors to take into consideration the interests of different stakeholders? Do directors breach their duties if they implement corporate social responsibility?
2. What problems might appear if more duties are imposed on directors?

1. Does the *Corporations Act* allow directors to take into consideration the interests of different stakeholders? I believe that it does, because when directors comply with corporate social responsibility, such compliance will have positive effects on the company itself. A study in Canada has shown that when small and medium companies

[27] Philip K Howard, *The Collapse of the Common Good: How America's Lawsuit Culture Undermines Our Freedom* (Random House, 1994), 11.

implemented corporate social responsibility their businesses profited from their initiatives.[28]

Let's take the most damning example: James Hardie's treatment of its employees suffering from mesothelioma caused huge problems for the image of the company. The company's shares, reputation and business suffered. But when the directors of James Hardie acted in a more socially responsible way (even though it was done under pressure), their actions improved the situation of the company. James Hardie recovered its status of good corporate citizen and that led to an increase of the company's share price and profit. The directors did not breach their duties when they recognised the interests of the company's stakeholders (the asbestos victims), because such recognition benefited the company and in the end its shareholders.[29]

Another example is BHP Billiton, a company which is today taking a leadership position on climate change. Such an approach will give the company an edge in the eyes of government officials and could potentially deliver it access to government-controlled oil deposits. Ultimately, this implementation of corporate social responsibility will benefit the company and thus the shareholders. Its directors will not have breached their duties.

What about donations? Are corporate donations allowed? Some groups, like the ASA, note that directors should not commit to donations on behalf of the company because they are not using their money, but their shareholders' money. Is that totally true? Does the *Corporations Act* prohibit such donations? As long as the donations are going to benefit the company as a whole, they are not in breach of the *Corporations Act*. As a result, if the donations improve the image and reputation of the company, they will benefit the company and they should be allowed. Are the Tsunami donations legal? The answer is yes because they will benefit a company on many levels, such as:[30]

[28] Canadian Business for social responsibility, *Engaging Small Business in Corporate Social Responsibility* (October 2003) < http://www.cbsr.ca/files/ReportsandPapers/EngagingSME_FINAL.pdf> viewed on 16 February 2006.

[29] James McConvill, "Direcotrs' Duties to Stakeholders: A reform Proposal Based on three false assumptions" (2005) 18 *Australian Journal Corporate Law* 88.

[30] Peter Henley, "Where Corporate Tsunami Donations Made Legally?" (2005) 30 *AltLJ* 154, 157.

- by generating local and international publicity, and accordingly increasing brand awareness;
- by motivating its employees in showing that the company has the same beliefs as its staff. For example, ANZ matched its employees' tsunami donations;
- by avoiding negative publicity: there is not a company that would like to be seen as a bad corporate citizen.

If directors commit to such donations they would not be in breach of their duties because these donations are justifiable for they benefit the company. On the other hand, donations that are not justifiable would need shareholder approval because they won't benefit the company. For example, as considered previously, if a company gives money to a charity supported by a director's wife, such a donation can be considered as a breach of duty because a conflict of interest will exist. Should we allow such donations? The answer is we should not, because they are not just legally wrong but ethically wrong. Directors should not use a company's money and position to promote their own interests and such donations might do that.

In the end, the *Corporations Act* notes that directors need to take into consideration the best interests of the company as a whole. Does that mean that directors can't act in the best interests of the stakeholders? Again, the answer is no. The duty of directors towards the company as a whole means that directors have a duty to any stakeholder who might have an influence on the day-to-day operation of the company. This was confirmed in the 1989 report of the Senate Standing Committee on Legal and Constitutional Affairs. The report clearly noted the following:

> "The courts have associated directors' duties with the 'interests of the company'. This does not necessarily mean that directors must not consider other interests. The 'interests of the company' include the continuing well-being of the company. Directors must 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."

The *Corporations Act* does not stop directors from taking into consideration the interests of different stakeholders. They can do so as long as their action does not breach the legislation. **The interests of the company and the interests of the stakeholders are interdependent** because a company can't function without the support of its suppliers, consumers, shareholders… Directors will be breaching their duties under the *Corporations Act* if they do not try to ensure the long term financial stability of the company. Such stability will only be reached if the directors take into consideration the interests of the relevant stakeholders.

2. What problems might appear if more duties are imposed on directors?

The first problem that might arise if the *Corporations Act* imposed more duties on directors is that directors might be faced with more legislation than is necessary because directors do not merely have to comply with the *Corporations Act*. Directors of companies must obey laws relating to environmental protection, taxation, occupational health and safety, trade practices and consumer protection, as well as many others. Failure to comply with these laws not only exposes companies to potential fines but, in appropriate cases, directors and officers can be held personally liable, both civilly and criminally.[31]

Adding more legislation might lead to duplication and contradictions between the *Corporations Act* and the other laws in place. When legislation puts a high burden on the community, such legislation may be seen as unreasonable and those regulated do not always respond positively: their actions can become shaded with anger and resentment at the departure from common sense. This leads to the application of the following vicious cycle:

[31] R Baxt and I Ramsay, 'Corporations law a fragile structure', *The Australian Financial Review*, 19 November 2004, p 55.

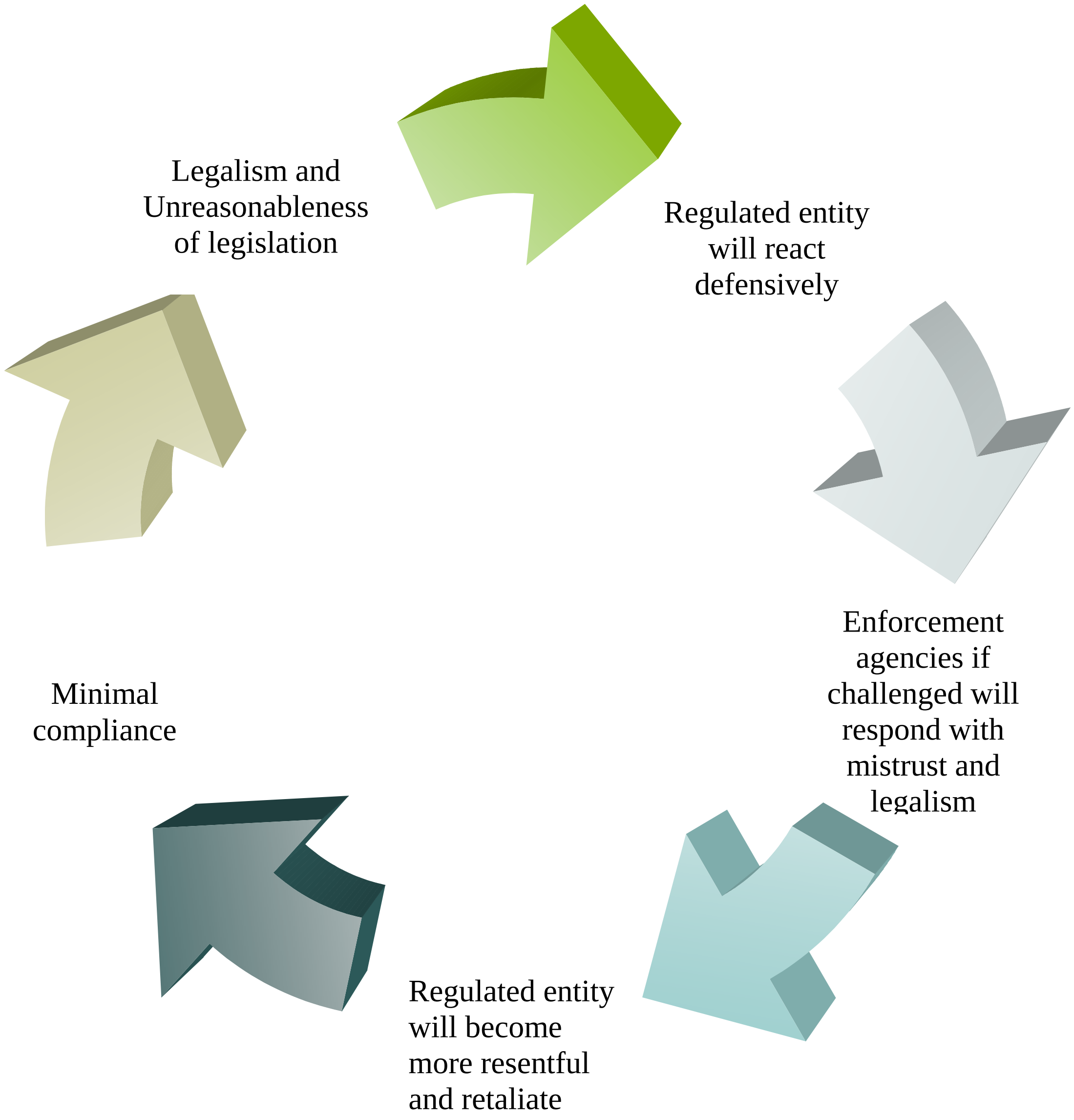
Legalism and
Unreasonableness
of legislation
Regulated entity
will react
defensively
Enforcement
agencies if
challenged will
respond with
mistrust and
legalism
Regulated entity
will become
more resentful
and retaliate
Minimal
compliance

Figure 2: Vicious cycle resulting from excessive legalism and unreasonableness of legislation.[32]

Resentment toward the regulator can blossom if those regulated believe that the rules imposed are unreasonable or excessively legalistic. For instance, if regulated entities have a fine imposed on them when they believe that they acted responsibly, the result can be counter-productive. Some business managers might respond by taking the position that they will act no more responsibly than the regulator's rules require them to. Such an

[32] This figure is based on information given by Bardach and Kagan, above n 31, 105. This author took the information and formulated it in the form of Figure 2.

attitude will sadly lead to minimal compliance and yet more legalistic and unreasonable legislation.[33] Accordingly, any new changes to the *Corporations Act* need to take into consideration such a scenario. Telling directors what is in the best interests of the company might backfire, because what can be seen as a positive endeavour for one company might have a catastrophic effect on another.

The second problem that might arise is in defining the stakeholders. Who will be considered as stakeholders? Is it the community at large or certain people whose interests are linked to the company?

The third problem is connected to the market mentality: 'Don’t miss a quarter'. As noted previously, companies will usually profit from implementing corporate social responsibility. But the accruing benefit might take some time to be felt. Accordingly, directors will be under pressure: provide quick profits or risk seeing the shares of the company plummet. Such a dilemma might push directors away from corporate social responsibility. A change in the mentality of both directors and shareholders is needed. There should be an understanding that a high share price today will not by itself guarantee future success. It is the policies of the company that will ensure the survival of the organisation. People need to be educated that the effect of corporate social responsibility might not be felt directly, but it will benefit the company in the long run. This third problem is not really with what duties might be imposed on directors by more legislation, but with the mentality of both directors and shareholders in automatically linking the price of a company's shares to its success. It is not always the case that one represents the other. Just look at the WorldCom example. No amount of legislation will change such mentality, however: education alone can.

In the end the question that can be asked is: Do we need to broaden the duties of directors? The answer is no. What we can do is provide guidelines to assist directors in their implementation of corporate social responsibility, and these should include educational courses to enhance directors’ understanding of their duties in relation to

[33] Eugene Bardach and Robert A. Kagan, above n 31, 105.

corporate social responsibility. The directors' duties imposed by the current *Corporations Act* are enough to cover the actions of directors because as long as the directors implement corporate social responsibility in the interests of the company, they will not be breaching their duties.

Are any changes needed to the current law regarding the right of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?

No legislative changes are needed to give members the right to express their view by resolution at general meetings on matters of environmental or social concern. If members want to do such a thing they need simply alter their constitution to allow themselves such powers. The choice should be left to individual companies and ultimately their shareholders.

3. Directors' duties: matters for consideration

Should the Corporations Act be revised 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?

The *Corporations Act* should not be revised to clarify the extent to which directors may take into account the interests of stakeholders. Such a situation should be left to the discretion of the directors because each company is unique and each has different requirements. Enacting more legislation in the guise of guiding directors will lead to excessive legalism, unreasonableness and, ultimately, resentment. Directors are the people best placed to know what will benefit their companies.

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

The *Corporations Act* should not be so revised because it already requires directors to take into account the interests of the different stakeholders. Directors are supposed to act for the best interests of the company as a whole and that includes stakeholders. A company cannot function in the long run without doing so.

4. Corporate reporting

Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

The recent increase in corporate social reporting over the years is linked to the demand for greater accountability and transparency of companies: key stakeholders today not only expect businesses to have a positive social and environmental impact in the world, they also want to be kept informed on how companies are performing in this respect. The financial community is a key driver for corporate social reporting.[34] Some people have criticised corporate social reporting by commenting that some reports are little more than spin. The perfect example of this can be found in Enron's rosy and glossy corporate responsibility annual report, which noted for instance the following:

> "Enron's Code of Ethics is published in English, Spanish, and Portuguese and distributed with universal acknowledgement and agreement to comply by its employees. Among other areas of coverage, the Code of Ethics specifically reinforces Enron's Principles of Human Rights and the Environmental, Health and Safety Principles; and **states that business is to be conducted in compliance**

[34] Employment, Social Affairs and Equal Opportunities, *Responsible reporting*, < http://europa.eu.int/comm/employment_social/soc-dial/csr/060403_cover_en.html > viewed at 13 February 2006.

> **with all applicable local and national laws and regulations, and with the highest professional and ethical standards**."[35]

Unfortunately, this paragon of corporate social responsibility collapsed under the weight of its executives' greed and criminality.[36] Another example is Shell, which has a much publicised corporate social responsibility policy and was a pioneer in triple bottom line reporting,[37] but was involved in 2004 in a scandal over the misreporting of its oil reserves which seriously damaged its reputation and led to charges of hypocrisy.[38]Putting to one side such sad realities, while most of the corporate social responsibility reporting done today is voluntary, some countries have put in place mandatory reporting. If the *Corporations Act* was to require certain types of companies to report on the social and environmental impact of their activities, this would have mixed repercussions.

On the one hand, the company will attract certain investors who are interested in the social and environmental impacts the company is having on the community. Such reports would also allow shareholders to know what their company is doing and how its actions are helping society.

In Canada, the government noted that the publishing of such reports was very useful because it had:

- internal benefits to the company by keeping the workplace informed and motivated, by improving data collecting in the company, by giving information to the public about the company's performance, and by ensuring the functioning efficiency of the company;

[35] Enron, Corporate Responsibility Annual Report, 9, <http://www.enron.com/corp/pressroom/responsibility/CRANNUAL.pdf> viewed on 14 February 2006.

[36] Joel Bakan, *The Corporation: the Pathological Pursuit of Profit and Power* (Free Press, 2005), 57-58.

[37] Juergen Daum, "A Revolution in Stakeholder Oriented Corporate Disclosure- Case Study: The Shell Report" (12 May 2001), *The New Economy Analyst Report* < http://www.juergendaum.com/news/05_12_2001.htm> viewed on 11 February 2006.

[38] Wikipedia, *Corporate Social Responsibility*, <http://en.wikipedia.org/wiki/Corporate_Social_Responsibility> viewed on 13 February 2006.

- external benefit to the company by improving the reputation of the company.

In France, reporting has been found to benefit companies by improving the dialogue between different categories of stakeholders.

On the other hand, imposing more reporting requirements on companies might have some adverse effects. Firstly, the financial cost of compiling and publishing such reports might be high. Secondly, companies will spend time collecting data to generate the reports, which might otherwise have been directed to finding new ways to improve business practice. Such reports are intended to drive performance improvement, thus the process of gathering data to compile the reports should be streamlined, but this seems rarely to be the case.[39]

Thirdly, the information required to be included in such reports would need to be specified and standardised. The guidelines in the Global Reporting Initiative would be a good place to start. However, adjustments might need to be made to ensure their requirements are easily adoptable by Australian companies. French companies had difficulties implementing all the guidelines in the Global Reporting Initiative because some were too AngloSaxon and not relevant in France. In addition, the information required to be reported should be useful to the company and to the community.[40]

Fourthly, any introduction to the *Corporations Act* of regulation in relation to corporate social responsibility needs to be reasonable, taking into consideration both the content and form of any reports that are required to be made. In 1977, Bardach and Kagan began a study on the pro-regulation movement that was at its height at this time. They noticed that a good deal of the regulation in place around the world was self-defeating. Their research demonstrated that increasing regulation would not ensure the protection of the

[39] Mallen Baker, "CSR Reporting faces its next challenge" 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

[40] Ibid.

community, because even the best regulation can produce a deplorable result if it is considered by the public to be unreasonable. Even if the “unreasonableness” of a regulation is unintended and is incidental to the accomplishment of a larger purpose, it may still be felt as unreasonable by the individual subjected to it.[41] Accordingly, if any reporting required did not serve a particular purpose, the business community might view the requirement to report as a burden and a backlash could take place.[42]

An important lesson that may be derived from a review of the corporate social responsibility reports published to date is that such reports need to be targeted to the selected audience. Vast amounts of money and time go into the production of these reports and it is known only too well by the companies that the stakeholders at whom the reports are aimed largely don't read them. Sooner or later, businesses will begin to question the use of these reports. No-one wants to continue to spend half a million dollars on reports that are not read. For this reason, some companies are issuing reports specifically targeted at certain elusive audiences. For example, the Centrica report, as well as being produced in conventional form, is produced in a separate edition for employees. The employees' report is based on the same information, presented in more of a 'magazine' format to make it more attractive to that audience. It is very possible that different reporting channels for different key stakeholders are essential to ensure that the reports are actually being read, and this should be taken into consideration by any legislation planning to introduce mandatory reporting on corporate social responsibility.[43]

Any legislation should likewise ensure that that the expectations of what these reports can tell us are not unrealistic. A company's financial reports will necessarily provide something much more concrete, for figures are figures and, properly gathered and represented, they will give an accurate indication of the financial situation of the company. Corporate social responsibility reports deal with more intangible matters. It is

[41] Eugene Bardach and Robert A Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Temple University Press, 1982) ix, 6.

[42] See Figure 2.

[43] Mallen Baker, “CSR Reporting faces its next challenge” 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

very rare when the content of a corporate social responsibility report gives an indication of how a company is doing. As a result, many reports contain lots of photos of smiling children which try simultaneously to present data and to tell stories. The company becomes its own interpreter - and that is why so much of the focus on reporting remains on the quality of the report, rather than on what the report is actually telling us.

Lastly, other questions should be asked: How are we going to monitor that what is said in the report has actually been, or is going to be, applied? What penalties should be imposed for breach of the reporting requirements? For instance, should they be the same as the penalties applied for breach of general disclosure requirements? Any legislation implementing a corporate social responsibility reporting requirement needs to provide a system for monitoring that reporting. The person or body monitoring the reports would need clear guidance.

It is interesting to look at how other countries have dealt with compulsory reporting on corporate social responsibility. In France, legislation requires all French companies listed on the "premier marche" to include in its annual report information on how that company is addressing the social and environmental impact of its activities. The law also indicates what information should be included in the report. The reasons behind the implementation of the French legislation are the following:[44]

- to ensure transparency in the way companies deal with social and environmental issues by showing the consequences of their activities in the social and environmental areas;
- to compare the different performances of companies in those areas; and
- to encourage French companies to follow the international movement in relation to reporting on corporate social responsibility.

[44] *Rapport de Mission Remis an gouvernement: Bilan Critique de l'Application par les enterprises de l'article 116 de la loi NRE*, April 2004 < http://www.orse.org/fr/home/download/rapport_NRE.pdf> viewed on 10 February 2006.

In 2004, the French government asked Orée, Orse and EpE to report on the method by which French companies are applying section 116 of the *Nouvelles Regulations Economic* and here are a few of their observations:[45]

- One difficulty is the distinction between information required by legislation to be included in the report and information companies are voluntarily giving to the public which is not required by legislation. This causes company reports to be different in style and content, with some companies fulfilling their obligations under the legislation and others going beyond what the legislation requires. This lack of uniformity can occur because the legislation is couched in broad terms. The forms of reports varied considerably, and the smaller the company the less the report complied with the legislation. Some companies produced stand alone reports and others included this reporting as part of their annual report.
- The requirements of the law were vague and sometimes difficult to apply, causing some problems for companies. In addition, while the requirements were relevant to enterprises which dealt with specific activities, they might be difficult to apply for companies that had many activities. The three associations suggested that the requirements should only be applied to companies to the point where it actually served the companies' interest.
- The cost of the reports can be crippling for an organisation. (It was noted that a report could require 12 employees to work for six months collecting the necessary data, the publication costs

[45] Mallen Baker, "CSR Reporting faces its next challenge" 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

could reach 100 000 euros, and the cost of external certification of reports could be high.)

- The companies found it difficult to target all the interests of the different stakeholders in one document.

In France, the legislation in relation to reporting seems to be accepted by both the companies and the stakeholders, and the people who criticised mandatory reporting no longer question the benefits of such reporting. In spite of the reporting requirement being accepted by French companies, it is not being applied properly by all of them, and in addition a single report does not necessarily answer all the questions of the different stakeholders.[46]

In Germany, research done in 2004 compared ten selected corporate social responsibility reports from companies listed on Germany's DAX-30 index. This exercise found that most of the companies were quite advanced in their reporting of environmental matters, but they devoted less attention to the issues of countering corruption, taxes and subsidies.[47]

5. Encouraging responsible business practices

Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

I believe that companies should be encouraged to adopt socially and environmental business practices because it is the way of the future. Corporations have been given huge powers. They have all the benefits of being a legal entity but they don't have the limitations. For decades we have been removing limitations on companies and extending their powers without thinking of the consequences. Today a company has perpetual

[46] Ibid.

[47] Thomas Loew, Kathrin Ankele, Sabine Braun and Jens Clausen, "Significance of the CSR debate for sustainability and the requirements for companies (30 June 2004) < http://www.4sustainability.org/downloads/Loew-etal-2004-CSR-Study-Summary.pdf > viewed on 14 February 2006.

existence, may enter into any contract it wants, and can be involved in any business. Our world revolves around corporations. Without them we cannot properly function. So it is time to hold those corporations liable, socially and environmentally. It is time to reshape the corporate citizen by encouraging corporations to be more socially and environmentally responsible. Obviously this can't happen in one day, and for this reason I propose the following system.

Companies are artificial creations that are not bound by personal morality. However, companies are motivated by profit and the maximisation of their shareholders' return. Profit usually takes precedence over community well-being, worker safety, public health, peace, environmental preservation and national security. Accordingly, all the decisions a company will make are usually motivated by profit. The practice of "greenwashing" has appeared and is intended to coax more people to buy a company's products, services or stock by letting the company's persona appear altruistic. As a result, a company will practise corporate social responsibility as long as such a practice serves its purpose. But when benefits do not accrue, such practices will be put aside. For instance, Exxon Corporation executives realised that their spending to mitigate damage to Alaskan shores after the Valdez oil spill was not swaying public opinion enough to benefit the company's bottom line. As a consequence, they dropped their pretence of ethical behavior and stopped the cleanup.[48]

This example illustrates that whether or not companies will practise, or continue to practise, corporate social responsibility is connected to profit. Since this is the case, the best way to motivate companies to commit themselves to voluntary initiatives in relation to corporate social responsibility is to give them an incentive to do so. A system of reward is the best solution: apply corporate social responsibility properly and you will be rewarded for it. For maximum success, the incentive should affect the profit of the company.

[48] Jeff Milchen, "Inherent Rules of Corporate Behavior" <http://reclaimdemocracy.org/corporate_accountability/corporations_cannot_be_responsible.html> viewed on 12 February 2005.

Rewards can play a positive role in compliance. They encourage regulated firms to abide by the law by giving them incentives to do so. Positive incentives can take the form of green stickers, grants, subsidies, bounties, fees and commissions, tax breaks or loan guarantees.[49]

Today there are certain private organisations such as the Association of Chartered Certified Accountants that give awards for sustainability reporting in order to encourage better sustainability reporting and to serve an educational role. But a broader arrangement is needed. Governments, and not just private organisations, need to get in on the action and make companies feel that if they miss out on the rewards offered their bottom line will be affected.

Government can encourage companies to be more socially and environmentally aware by noting that companies implementing corporate social responsibility will be granted government contracts while companies that do not practise corporate social responsibility will miss out, for instance.

The linking of corporate social responsibility and corporate profit will remove certain dilemmas faced by directors: directors will be able to apply moral standards without fearing a backlash from shareholders, because their actions will be motivated by profit. If they won't act in accordance with corporate social responsibility, their bottom line will suffer because they will lose all financial rewards they might have got if they had implemented corporate social responsibility.

A second way to encourage good corporate governance practice is to issue reports on companies' performance to show the companies that their efforts are being acknowledged. This is already being done in the form of surveys and indices. The

[49] Peter N Grabosky "Regulation by Reward: On the Use of Incentives as Regulatory Instruments" (1995) 17 *Law and Policy* 257.

positive or negative publicity generated by these reports may lead companies to be more motivated to implement corporate social responsibility. [50]

The problem with this method is that it attracts lots of criticism in relation to bias and the existence of conflicts of interest between companies and the people in charge of the surveys or indices. For instance, Laurel Grossman developed the Reputation Index, and then RepuTex. The RepuTex is a product that is very different from stockmarket indices (such as the Dow Jones Sustainability Index) which are investment tools, or the GRI (Global Reporting Initiative) which is really a reporting model. The Good Reputation Index (later becoming the RepuTex) was unique and looked at companies from a different perspective.[51] The strongest criticism of the RepuTex, however, concerns its lack of partiality and the conflict of interest. The Business Council of Australia complained (and still complains) that the RepuTex ratings are based on the views of a small group of apparently arbitrarily selected organisations which will lead some of them to be partial to particular corporations. For instance, in the first Good Reputation Index in 2000, the St James Ethics Centre rated Leighton Holdings "tops on ethics", but the organisation failed to disclose that it had given Leighton advice on ethics in return for a fee after Leighton had suffered adverse findings in a Royal Commission. The IPA's Mike Nahan noted that the St James Ethics Centre "had financial relationships with 37 of the 100 corporations in the Index and disclosed none of them."[52]

Another criticism is: who is actually financing the reports that are being made? RepuTex now is raising funds by selling the 650-page report of its assessments for the price of $25,000 each to the companies involved and any other person who is interested in purchasing the report (it is safe to say that only sophisticated or institutional investors will be able to afford the report; small investors will not). This has released a deluge of complaints. Some commentators even labelled it extortion. However, it is important to note that it is not compulsory to buy the report. For instance, the company which

[50] Colleen Ryan, *The reputation wars*, <http://www.afrboss.com.au/magarticle.asp?doc_id=22574&listed_months=14> viewed on 12 February 2005

[51] Ibid.

[52] Ibid.

received the top rating this year, Westpac, declined to purchase it to avoid any signs of conflict of interest. Accordingly, for any report on corporate social responsibility to have an impact it needs to be impartial and to be independently funded, which is in itself hard to achieve.[53]

A third method that may be used is education. I believe that promoting corporate social responsibility through education is very useful because it will ensure that businesses are aware of the notion of corporate social responsibility and that they understand the concepts it involves and how to apply it. A critical element in a successful implementation of corporate social responsibility is the understanding of the officers of the company of the importance of corporate social responsibility. This understanding ensures the commitment of key people in the company, such as directors and senior managers, to integrate the values and visions of corporate social responsibility into the company and its culture.[54] Education will help companies to apply not only the letter of the law and codes, but also the spirit that is behind them. Education will also help employees to determine current practices in corporate social responsibility. But education by itself is not enough. It needs to be implemented with something else such as a reward system for the practice of corporate social responsibility.

For its voluntary initiatives to be fruitful, a company needs to apply them properly. It is important to note that not every time a company says it is complying with corporate social responsibility principles it is actually doing so. On many occasions companies say that they are doing everything they can to help the community when in reality they aren’t doing much beyond giving the appearance of being good corporate citizens. For instance, Coca-Cola stresses that it is 'using natural resources responsibly', yet a wholly-owned subsidiary in India has been accused of depleting village wells in an area where water is in notoriously short supply and has been told by an Indian court to stop drawing from

[53] Ibid.

[54] Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

ground water.[55] In relation to this issue, Coca-Cola's claims of corporate social responsibility mean nothing, because it is not applying what it is preaching.

Even worse, evidence has emerged that at least in some cases, factory officials in charge of manufacturing consumer goods for Western markets are falsifying records in order to appear to be in compliance with the tougher labour standards demanded by their multinational corporate customers because they want to concentrate on making the highest profit possible at the detriment of human life and ethics.[56]

Conclusion

Corporate social responsibility should be taken into consideration by companies. However I do not believe that a change in the current legislation is needed. Directors already have a range of duties and responsibilities imposed on them by law. The current rules already cover the responsibility of directors towards the different stakeholders.

Changes in relation to corporate reporting in the *Corporations Act* might be a good idea, but before implementing any legislation, it is necessary to look at the problems faced by other countries which have put in place mandatory reporting in relation to corporate social responsibility, so that we will not repeat mistakes that have been made. Watching further developments in these countries over a longer time period may be beneficial.

Companies should be encouraged to apply corporate social responsibility through a system of rewards and education. The reward system will show the company and shareholders that the company is benefiting from being a good corporate citizen, and education will teach the officers and employees of the company the importance of corporate social responsibility.

[55] Christian Aid, *Behind the Mask: The Real Face of Corporate Social Responsibility*, < http://www.christianaid.co.uk/indepth/0401csr/index.htm> viewed on 12 February 2005.

[56] Oxfam GB, "Play Fair at the Olympics," *Clean Clothes Campaign, and Global Unions*, March 2004.

CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

24 February 2006

Mr John Kluver
Executive Director
CAMAC
Level 16
60 Margaret Street
SYDNEY NSW 2000

By mail
and by email: john.kluver@camac.gov.au

Dear John

Corporate social responsibility

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the CAMAC discussion paper *Corporate Social Responsibility*.

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We are an independent, widely-respected influencer of governance thinking and behaviour in Australia and an expert commentator on issues affecting governance and legislation. We represent over 8,500 governance professionals working in public and private companies, as well as in the public and not-for-profit sectors, who have a thorough working knowledge of the issues relating to corporate responsibility.

In preparing this submission, CSA has drawn on the expertise of the members of our two national policy committees.

Yours sincerely

Tim Sheehy

Tim Sheehy
CHIEF EXECUTIVE

Chartered Secretaries Australia (CSA)

Submission to the Corporations and Markets Advisory Committee (CAMAC) in relation to the discussion paper *Corporate Social Responsibility*

CAMAC discussion paper
Corporate Social Responsibility

Section 1.5

(a) How might corporate social responsibility (CSR) usefully be described for working purposes?

One of the challenges in commenting on CSR is the difficulty of developing commonly accepted terminology and definitions. Terms such as CSR, corporate responsibility, sustainable development, socially responsible investments and triple bottom line reporting have become synonymous in the minds of many corporate directors, managers, investors and academics.

Definitions

To clarify how the various terms interrelate, it is useful to look at the definitions of individual terms:

Corporate social responsibility (CSR)

Some companies use sustainability or corporate citizenship instead of CSR. Some argue that the ‘social’ in CSR detracts from the business-related responsible activity by focusing on its social impacts (typically in the community area) while not giving due regard to the importance of ensuring the company’s operations are run ethically and responsibly.

Fundamentally, CSR is about relationships between the company and its stakeholders and building trust. CSR is about how companies manage the business processes to produce an overall positive impact on society.

As noted in an article by Ann Durie published in CSA’s journal, *Keeping good companies*, ‘The aim of sustainability reporting is to report on this relationship of trust in a way that is believable. The only way to make the reporting credible is to *be* credible… For an organisation, being credible is about first determining with whom it has an interdependent relationship. The corporation is primarily responsible to those within its direct sphere of influence. The recognition of a tangible interrelationship with contextual parameters enables some form of qualitative or quantitative measurement’.[1]

While the wording varies from one definition to the next, the elements remain fairly constant. The elements involve determining those individuals or groups with whom an organisation has a relationship of interdependence, that is, stakeholders.

Stakeholders

A stakeholder is an individual or a group that can affect the organisation, or is affected by the organisation’s activities at any time, either now or in the future. This definition can include employees, suppliers, local communities, single issue groups, government and the wider society, as well as shareholders. As noted in the *ICSA Corporate Social Responsibility Handbook*[2], ‘A similar, but more explicit definition of a stakeholder came from a conference in London and was quoted in the media column of *The Financial Times* on 14 September 2004 as: “Anyone that can bugger up your business”’.

[1] Durie, A, ‘The writing on the wall: the CSR imperative’, *Keeping good companies*, Vol 56, No 7, August 2004, p 403

[2] Hoskins, T, *The ICSA Corporate Social Responsibility Handbook*, The Institute of Chartered Secretaries and Administrators, London, 2005, p 181

Ann Durie further comments that, ‘In a study in 1998, Warticke and Wood defined the power bases from which stakeholders operate.[3] Those holding voting rights have formal power and are the traditional stakeholders, such as shareholders and directors. The groups able to affect revenue flows, such as employees, suppliers, creditors and customers, wield economic power. Pressure groups, the community, activists and governments hold political power. The sustainability reporting tools in current use determine stakeholders to be any of those from within these groups.’[4]

Sustainable development

The generally accepted definition of this term is that used in the Brundtland Report in 1987: ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’.[5] Four moral concepts underpin this definition: equity today; environmental justice; intergenerational equity; and stewardship.[6]

Socially responsible investment

Socially responsible investment (SRIs) is the integration of personal values and societal concerns with investment decisions. ‘SRIs provide a link between those individuals or institutions that hold investment capital and corporations that report on their social and environmental performance. The link is provided in a way that brings the activities and results achieved by the corporation into line with the investment mandate.’[7]

Triple bottom line reporting

Triple bottom line reporting to stakeholders focuses on the economic, social and environmental aspects of corporate activities. Information on the approach and performance of companies in managing the environmental and social impact of their activities, as well as financial data, is released by a corporation, to obtain a holistic view of the state of affairs within the corporation. Financial data is one indicator of the success of performance, but may mask systemic risks. The triple combination of reporting the social and environmental outcomes, as well as the financial aspects of a corporation’s activities, provides information on the expertise of management and the potential risks associated with the operations of the corporation.

These concepts are inextricably intertwined, yet separate and distinct from each other.[8]

(b) Which combination or combination of approaches to responsible corporate behaviour is most appropriate?

CSA is firmly of the view that no one approach or combination of approaches can be mandated as the most appropriate. Indeed, CSA believes that it is useful for companies and their staff to have an understanding of diverse concepts such as CSR, sustainable development, triple bottom line reporting and socially responsible investment, as this will allow each company to

[3] King, D, *Corporate Citizenship and Reputational Value: The Marketing of Corporate Citizenship,* The Hawke Institute, University of SA, 2000, p 39

[4] Durie, A, ‘The writing on the wall: the CSR imperative’, *Keeping good companies*, Vol 56, No 7, August 2004, p 404

[5] World Commission on Environment and Development, *Our Common Future*, Oxford University Press, Geneva, 1987

[6] Durie, A, ‘The writing on the wall: the CSR imperative’, *Keeping good companies*, Vol 56, No 7, August 2004, p 402

[7] Social Investment Forum, *2003 Report on Socially Responsible Investing Trends in the United States,* SIF Industry Research Program, December 2003, p i notes that in the USA in 2002, a particularly bad year for stock market investments, socially responsible investment funds had a net inflow of $1.5 billion, compared to all other funds, which experienced a net outflow of $10.5 billion

[8] Durie, A, ‘The writing on the wall: the CSR imperative’, *Keeping good companies*, Vol 56, No 7, August 2004, p 403

devise a CSR strategy most appropriate to that organisation’s capacity to effectively monitor, measure and report on its CSR performance and its relationships with its stakeholders.

(c) What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

The values of CSR sit at the heart of good governance. The OECD, in its introduction to its report *Principles of Corporate Governance*[9], states that, from a company’s perspective, corporate governance is about:

> Maximising value subject to meeting the corporation’s financial and other legal and contractual obligations. This inclusive definition stresses the need for boards of directors to balance the interests of shareholders with those of other stakeholders – employees, customers, suppliers, investors, communities – in order to achieve long-term sustained value.

The benefit of this approach towards corporate governance is that it recognises the broad objective of maximising shareholder value, while acting fairly in the interests of other stakeholders with an interest in the company’s affairs.

There are those of the view that the corporation is a profit-seeking machine with a ruthless disregard for long-term consequences. This view implies that social issues are peripheral to the challenges of corporate management. It claims that the sole legitimate purpose of business is to create shareholder value. Proponents of this view believe that any argument proposing that a company should mitigate its social impact is irrelevant. The belief that a corporation’s sole reason for existence is to increase its wealth was strongly expounded in the 1970s and can be traced to Milton Friedman’s argument that: ‘There is one and only one social responsibility of business: to use its resources and engage in activities designed to increase its profits’.[10]

The view that has greater traction in the twenty-first century is that the relationship between business and society is an implicit social contract. Proponents of CSR note that social issues are not tangential to the business of business but fundamental to it. This perspective holds that corporate managers holding onto a one-dimensional view of the corporation will not survive, nor will the companies they manage. Indeed, a recent global survey of corporate executives revealed that, overwhelmingly, executives embrace the idea that the role of corporations in society goes beyond simply meeting obligations to shareholders.[11]

Supporters of CSR note that those companies alert to the long-term impact of social issues and in a constant dialogue with their stakeholders have a competitive advantage. Shifts in social issues that ultimately feed into the fundamental drivers of corporate performance generate value-creation opportunities. ‘Paradoxically, the language of shareholder value may, in this respect, hinder companies from maximising their shareholder value. Focusing on a ‘business is business’ approach can lead managers to emphasise short-term company performance, while neglecting longer-term opportunities and issues, including societal pressures, the trust of customers and investments in innovation and other growth prospects.’[12] For reasons of ethics and enlightened self-interest, companies need to tackle such issues, both with words and actions. There is, therefore, considerable incentive for a company to conduct its business in a socially responsible manner.

[9] OECD, *Principles of Corporate Governance*, first published 1999; revised 2004, Paris, OECD

[10] Friedman. M, *The New York Times*, 13 September, 1970

[11] *The McKinsey Global Survey of Business Executives: Business and Society*, December 2005: *The McKinsey Quarterly* conducted the survey in December 2005 and received responses from 4,238 executives, more than a quarter of them CEOs or other C-level executives, in 116 countries

[12] Davis, I, ‘What is the business of business?’, *The McKinsey Quarterly*, 2005, No 3

There are powerful social rewards and sanctions associated with responsible behaviour. Acting responsibly generates trust, loyalty and goodwill among customers and employees, not to mention business partners. Corporate irresponsibility, on the other hand, can result in disapproval and suspicion, public criticism, damage to customer loyalty, loss of brand equity and a tarnished corporate reputation. Responsible behaviour creates a sense of satisfaction and self-respect among employees, whereas irresponsible behaviour can result in feelings of embarrassment, guilt, shame, cynicism and poor morale and loss of commitment from employees.

Disincentives, therefore, can include loss of reputation, incapacity to attract and retain good staff, shocks to the share price for listed companies, boycotting of products and services by customers and penalties imposed by regulators.

(d) Do different or additional implications arise depending on the nature or size of the enterprise, for instance, the sector or industry in which an organisation operates, or whether a company has international operations?

It is sometimes argued that CSR is difficult for small to medium-sized enterprises (SMEs). It needs to be clarified that a socially responsible approach to business is not difficult for SMEs with an interest in long-term sustainability; however, reporting such approaches can be problematic.

This is because it can be costly to capture and provide the relevant information to demonstrate a company's responsible approach towards its society and environment, especially if that company is not already capturing such information for its management purposes. SMEs are less able to apply dedicated resources to the reporting of any responsible approaches they may take than are large organisations.

Owner-managers are already participating in responsible approaches, although they may not describe them as being part of CSR. Public discussion of the concepts mentioned above (CSR, sustainable development, socially responsible investment and triple bottom line reporting), leading in turn to greater familiarity with such concepts, will be useful to assist owners, managers and employees in all sizes of enterprise to clarify what constitutes CSR. Such clarity will assist SMEs not only to make informed decisions as to which approaches they believe to be most appropriate to them, but also to communicate with stakeholders using a shared language.

The reporting of CSR by larger companies in Australia note that they are beginning to encourage SME suppliers, through their supply chain, to become more CSR-active. For example, ANZ notes in its *Corporate Responsibility Report 2005* that it has 'developed a Sustainable Procurement Policy to be introduced into new and existing supplier contracts in 2006. The policy will guide the selection and evaluation of suppliers on the basis of environmental and social indicators consistent with ANZ's Environment Charter, including labour, health and safety standards and environmental impact'.[13] The challenge is to ensure that the practices suitable in larger companies can be modified to suit SMEs. The learning inherent in any such challenge provides the opportunity for SMEs to embed such practices within their culture. Mandating one particular approach will cancel any such learning opportunities, as companies will not be engaged to devise innovative approaches to ensure their long-term interests and generate competitive advantage.

[13] Australia and New Zealand Banking Group, *ANZ Corporate Responsibility Report 2005*, p 7

The nature of CSR in an SME can be significantly different from CSR in a large company. For example, many multinational companies report against international reporting initiatives that were developed specifically for large organisations with a global footprint. A large organisation operating in multiple jurisdictions is concerned with the organisation's impact, both direct and indirect, on the economic resources of its stakeholders and on economic systems at the local, national, and global levels, including such matters as employee wages, financial arrangements with customers and suppliers, and taxes. Environmental impacts include the organisation's products and services; energy, material and water use; greenhouse gas and other emissions; effluents and waste generation; impacts on biodiversity; use of hazardous materials; recycling, pollution, waste reduction and other environmental programs; and the cost of non-compliance with environmental regulation. Social indicators concern an organisation's impacts on the social systems within which it operates, which can include labour practices (for example, diversity, employee health and safety), human rights (for example, child labour, compliance issues), and broader social issues affecting consumers, communities, and other stakeholders (for example bribery and corruption, community relations).

It has been noted that it is a challenge for SMEs to adapt and narrow the broad citizenship concepts implicit in the global reporting initiatives so that they have relevance for the CSR agenda of those enterprises with either a less significant global profile or none at all. SMEs think locally and act locally and will seek to develop and foster their own approaches to socially responsible performance.

The question of whether the particular sector or industry in which an organisation operates has implications for companies' CSR approaches goes to the heart of the need to maintain choice in socially responsible approaches. This is because different industry sectors face unique sustainability issues. For example, while the extractive industry is more likely to have a far greater impact on the environment than the financial services sector, the latter does have an environmental impact and must consider the sustainability issues it faces in that regard. Looking at what the extractive industry is doing on this front will not necessarily assist the financial services sector to devise CSR approaches suitable to it.

(e) In practice,

(i) to what extent is corporate decision making driven by stakeholder concerns?

(ii) how do companies differentiate between various categories of stakeholders?

(iii) in what ways do companies balance or prioritise competing stakeholder interests?

(iv) how do companies engage with stakeholders?

(i) To what extent is corporate decision making driven by stakeholder concerns?
CSA notes that companies, of their own initiative, already engage in activities that are driven by stakeholder concerns, without such initiatives having been mandated.

CSA also notes that there is an array of legislation and standards that currently exists regulating the centrality of stakeholder concerns in corporate decision making, as follows:

- Companies are subject to various state-based environmental legislation.
- A new section, s 299(1)(f), was introduced into the Corporations Law by the *Company Law Review Act 1998* (Cth), requiring companies to report on environmental performance.
- Companies are subject to legislation regulating relationships with employees and occupational health and safety (OH&S) standards, both at the state and federal levels.
- The objective of the *Trade Practices Act* is to enhance the welfare of Australians by promoting competition and fair trading and providing for consumer protection.

Consumers are protected under the *Trade Practices Act.* In addition, the tort of negligence enables an individual to sue a corporation for a civil wrong caused by the actions of the corporation.

- Companies are subject to financial services and taxation legislation at the federal and state levels.
- The Australian Stock Exchange Corporate Governance Council (ASXCGC) guidelines, released in 2003, recognise the legal and other obligations that listed companies have to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. Recommendation 10.1 notes that companies should establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.
- The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act* 2004 (commonly known as CLERP 9) commenced on 1 July 2004. It contains 13 schedules containing amendments to the *Corporations Act* and the *ASIC Act*. The financial reporting schedule (Schedule 2) deals with CEO and CFO declaration, management discussion and analysis (MD&A) and the new Financial Reporting Panel. The MD&A requirement is set out in the new s 299A. This section requires a listed public company directors' report to include information that members would reasonably require to make an informed assessment of the company's operations, financial position, business strategies and prospects. Any such information can include details of the company's engagement with stakeholders.
- Numerous voluntary codes of practice exist. For example, the resources sector developed the Minerals Industry Code in 1996, and 43 companies are currently signatory to this voluntary environmental management code.[14] Other examples include the AusBiotech and ASX Code of Best Practice for Reporting by Life Science Companies, the United Nations Global Compact, the Global Reporting Initiative (GRI), and Voluntary Principles on Security and Human Rights for the Extractive and Energy Sectors.

Beyond legislation and standards, members of CSA, in both listed and unlisted entities, can point to a range of existing CSR initiatives within their organisations. Based on information provided by the companies of some of our members, a few examples follow.

Listed companies

National Australia Bank (NAB)

The NAB participates in the Carbon Disclosure Project, a global assessment by 85 institutional investors on the extent to which the Financial Times (FT) 500 most valuable companies are taking carbon risk and climate change risk into consideration as part of their core business. A further initiative is becoming a signatory to the Statement for Financial Institutions (UNEP FI) in 2002. The UNEP FI is a collaboration between the United Nations and 240 financial institutions globally working together for improved outcomes through lending and investment. As a member of the UNEP FI/Global Reporting Initiative (GRI) working group, NAB is working to develop the environment indicators for the Environmental Finance Sector Supplement to the Global Reporting Initiative (GRI – see later in the submission). The supplement includes the development of key performance indicators for direct and indirect impacts, including lending and asset management. In 2004, NAB became a member of a global working group, which consists of seven international banks that are working together to develop the global best practice management toolkit for measuring and reporting direct impacts of finance institutions. This benchmark standard is called VfU.

[14] Bubna-Litic, K, 'Mandatory corporate reporting: Does it really work?' *Keeping good companies*, Vol 56, No 10, November 2004, p 616

NAB Australian businesses have facilitated an External Stakeholder Forum. The External Stakeholder Forum has representatives from prominent environment, community service and consumer groups, and indigenous and rural communities and has influenced the establishment of programs and facilities that seek to address financial services for low or vulnerable income members of the community.

NAB also supports the Total Environment Centre Green Capital Programs in Australia. The program aims to stimulate debate and raise awareness in Australia between environmental groups, community groups and business on environmental consequences of business operations and legislation. The NAB also designed its new building, National @ Docklands, with sustainability as a key design theme.

Caltex Australia Limited
Caltex Australia Limited undertakes contributions and sponsorship programs as part of its partnership with the community. The program is operated at three distinct levels: corporate sponsorships, that is, support for projects in the areas of welfare, the arts and education; regional sponsorship, which takes place with organisations in communities near Caltex’s major company facilities such as their two refineries; and local support with individual service station operators and distributors responsible for handling sponsorship in their immediate areas. Caltex will support environment research, including community education, air quality, community volunteers, conservation, marine ecology, wetlands and endangered species; public information and policy research, including engineering, economics, petroleum industry, social policy, business analysis and research; education in engineering, finance, management, information systems and science and activities supporting the development and employment of young people; health and safety preventative measures and research, including health promotion, safety projects and emergency services; community support, including family support, volunteering, job creation and equal employment opportunity; support of the performing arts; and charity aimed at building a better community, including education programs supporting self-help.

BHP Billiton
BHP Billiton undertakes a range of activities in relation to CSR issues throughout the world and reports comprehensively on these activities each year in accordance with the GRI. BHP Billiton’s 2005 Sustainability Report is available on its website. It is recommended that representatives of the Committee visit the website and review this report to gain an appreciation of the importance which BHP Billiton places on CSR.

Unlisted companies
Zurich Financial Services Australia Limited runs Community Connections. The program supports and encourages employees to engage with the community through the donation of their time and money. It is undertaken in partnership with United Way, a national not-for-profit organisation that supports a number of community organisations that make a difference in the lives of those in need at a local level. The program supports and encourages employees to engage in the community by:

- taking a day’s paid leave to volunteer at a community organisation of their own choosing
- participating in a team volunteering day
- donating money from their fortnightly pay, matched dollar for dollar by Zurich.

Zurich also recently launched a national Green Office initiative that encourages its offices to be more environmentally responsible. The program will initially focus on reducing the use of paper, energy and water, as well as introducing a comprehensive recycling system in a number of its offices.

Flinders Ports Pty Ltd sponsors the South Australian Maritime Museum, and funds the education program ‘A Day at the Port’ through the South Australia Investigator Science Centre. This program is targeted at primary school children and educates them about the workings of a port and the link with import and export trades. It also concentrates on local community programs, including the funding of travel for children in regional centres to attend events in the city of Adelaide.

(ii) How do companies differentiate between various categories of stakeholders?

In practice, stakeholders have different needs and expectations and need to be dealt with differently. Companies need to engage with their stakeholders on a stakeholder by stakeholder basis. How companies do this will differ from company to company, as is shown in the examples members can point to of companies with a range of existing CSR initiatives.

(iii) In what ways do companies balance or prioritise competing stakeholder interests?

Although some commentators perceive a tension between the interests of different stakeholders, resolving the balance or prioritisation of those competing interests is part of a company’s engagement with its stakeholders. A company will seek to identify the range of stakeholders, identify and rank issues through discussion with stakeholders, and map strategy against the issues, ensuring that a meaningful dialogue is held about the range of risks and opportunities that exists. This needs to take place regularly to ensure account is taken of changes in attitudes, not only in the company but also among the stakeholders. Thus any balancing or prioritising of competing stakeholder interests can only be conducted by individual companies in relation to their particular stakeholders. There is no manual to follow and an approach that works for one company will not necessarily work for another.

It is at the point of insolvency that stakeholder interests truly diverge, and there are existing mechanisms in the *Corporations Act* to deal with this.

(iv) How do companies engage with stakeholders?

Companies must be free to choose the forum, style and method of engagement with their stakeholders that best suits the needs of both the company and the different categories of stakeholders.

For example, the ANZ board has established a Nominations, Governance and Corporate Responsibility Committee, responsible for reviewing ANZ’s approach to, and strategies for, ensuring CSR is integrated into overall business performance. This is underpinned by various charters, codes of conduct and policies, and the establishment of a Corporate Responsibility Council composed of senior executives who work across the group and also within their businesses to encourage participation in the CSR agenda, to ensure an ongoing dialogue and, in some cases, multi-layered partnerships, with stakeholders.

The BHP Billiton board has established a Sustainability Committee which oversees BHP Billiton’s health, safety and environment and sustainable development functions. Engagement with stakeholders occurs at all levels, from the chairman’s liaison with shareholders and others, to the local community engagement programs at each of BHP Billiton’s sites around the world.

(f) In practice, to what extent do stakeholders consider a company’s socially responsible performance when making assessments or decisions about a company?

CSA notes that this issue largely lies outside the expertise of its members, although CSA notes that the reputational risk inherent in not attending to stakeholder needs is a factor that cannot be disregarded by any company seeking long-term sustainability.

(g) Are there any changes that could enhance triple bottom line, sustainability or like reporting, including:

- (i) increasing the level of clarity and comparability of these reports?
- (ii) any suggested changes to external verification of those reports?
- (iii) whether any aspect of this reporting should be mandated and, if so, for what companies and what respect(s)?
- (iv) are there particular issues for small to medium enterprises?

Although a number of social, environmental and ethical accountability tools are available in the public domain, there is no definitive reporting methodology for CSR. Research conducted in 2005 by CSA of members in listed companies showed that 79 per cent of such members have external bodies and organisations assessing and rating their organisation's CSR or asking the organisations to report on their CSR activities. Those same members note that 68 per cent of these reporting mechanisms do not share similar methodologies and measurement processes. This is in line with the fact that the surveyed members work in a variety of industries, and the reporting mechanisms reflect the industry-specific parameters.

A report gains relevance if it enables comparison between historical data and the implementation of future strategies and, currently, companies report against the most appropriate index for their industry. Industry-specific parameters can be determined and reported. This provides a gauge for outsiders, and the corporation itself, to assess its quality in relation to others within the same industry sectors. Identifying shortcomings and consequently determining strategies and setting goals for overcoming these is a vital element of the reporting process.

This is to be commended as the most appropriate way forward, rather than seeking one form of mandated reporting. Mandating one form of reporting will not provide for ready comparison of like with like. The ability for companies to recognise the key drivers that are most important to them will depend on their stage of growth, their operations and the communities in which they operate.

For example, the GRI has often been held out as a good model for mandated reporting. The GRI is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. Nonetheless, its mission has not been achieved, as the guidelines suit certain industries better than others. Furthermore, it has been acknowledged, including by the GRI itself, that its guidelines are not suitable for SMEs, although the GRI is keen to address this.

CSA also believes that mandating reporting adds a significant layer of additional costs to the operations of small listed and unlisted entities. Given the lack of evidence that small listed and unlisted entities are necessarily having significant impacts on the environment or the community, CSA does not believe that such a regulatory cost is justified. CSA strongly supports the continuation of voluntary reporting, with education provided to SMEs to communicate the value-creating opportunities inherent in CSR activity.

For example, in the extractive industry, smaller companies are seeking to attract capital and be competitive. If they do not voluntarily report against CSR indices on environmental issues, their capacity to attract capital and remain competitive will be hindered.

Verification of a company's CSR report involves costs and resources. CSA acknowledges that independent assessments are useful, but notes that, while large listed entities can afford the costs of such independent assessment, SMEs cannot readily afford them. Mandating verification would add a level of regulatory cost that CSA does not believe is justified for SMEs.

CSA also notes that the International Organisation for Standardisation announced in July 2004 that it is developing an international standard for CSR, aimed at providing guidance on implementing a CSR system to address social and environmental issues. CSA considers that Australia should monitor global initiatives in the field of CSR monitoring, measurement and reporting rather than trying to introduce a mandatory system that may conflict with global trends. CSA is not convinced that there is any benefit to the Australian community in pre-empting the ongoing international debate in this area.

CSA's members have expressed interest in seeing Australia consider examples of CSR initiatives in other jurisdictions such as the UK, where, for example, the London Stock Exchange has developed the Corporate Responsibility Exchange (CRE), which is an online tool that acts as a platform for companies to publish non-financial information, and for fund managers and research agencies to access it. Over half of the FTSE100 companies now use the CRE and our members would welcome similar voluntary moves in Australia.

Section 2.7

(a) Whether, and in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions.

As it stands, the law generally links a company's interests to those of its shareholders, and only derivatively with those of the community, consumers, employees and other stakeholders. With the increasing privatisation of public services, the expanding power of multinational corporations and the perceived diminution in the role of governments in the economy, the community increasingly looks to corporations as the provider of public goods and services. In light of this sociological evolution, many have questioned whether the law and community expectations sufficiently coincide, given that the law does not directly link a company's interests with those of stakeholders other than shareholders.

(i) Are shareholder interests the same as the interests of the company?

The *Corporations Act* states, in s 181(1), that:

> A director or other office 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.

It is important to clarify that the legislation does *not* state that directors and other officers must exercise their powers and discharge their duties in the best interests of shareholders, although it appears that case law has tended to grant primacy to shareholders' interests. It is a common misapprehension to believe that the legislation foregrounds shareholders' best interests and rights. It does not. It foregrounds the best interests of the company, which *generally* coincide with the best interests of shareholders.

CSA is of the opinion that the current legal framework governing directors' duties *does* accommodate directors having regard for the interests of stakeholders other than shareholders, as they must exercise their powers in the best interests of the company.

As noted by Bruce Cowley, in relation to the issue raised by the James Hardie case as to whether directors could be personally liable for being too generous in compensating victims:

> Ultimately, the question for directors and officers is whether they have carried out their duties as required by law. In theory, it is true that if directors and company officers are too generous with shareholder funds they can be personally liable. Their principal duties are to act with care and diligence and to exercise their powers in good faith in the best interests of the company and for a proper purpose. Excessive largesse in settling claims (of any kind) might be regarded as failing to act with care and diligence.
>
> However, directors and officers can argue the business judgment rule in defence of claims that they have failed to exercise the requisite standards of care and diligence. Under this rule, directors and officers will be deemed to have acted with reasonable care if they have made a decision in good faith and for a proper purpose about a matter in which they have no personal interest, a reasonable level of knowledge and a rational belief that the decision is in the best interests of the company….One would think that showing generosity to personal injury claimants might also constitute a proper purpose and be in the best interests of the company, especially if it impacts on the corporate brand.[15]

The discussion paper asks whether, and in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in relation to CSR. CSA believes that the law as it stands *accommodates* a regard for stakeholders other than shareholders, which in turn provides for directors and companies to reveal through their activities how capable they are of generating the value-creating opportunities as a result of engagement with stakeholders.

In Cowley's article cited above, he also noted that 'The position of company officers is not getting any easier and some of the more cutting-edge examples seem to be arising in relation to James Hardie and its associated entities. Without arguing for yet more law reform, it is clear that some of our recent corporate controversies have put existing laws under considerable duress.'[16]

CSA notes that, despite the duress our corporate laws have been under in relation to CSR, those laws did nonetheless withstand the pressure. One high-profile case study of a company's attempts to engage with its stakeholders, including its shareholders, should not form the basis of legislative reform. The presumption that companies feel constrained by their understanding of the current law of directors' duties in relation to CSR stems largely from the pressures experienced by James Hardie Industries. CSA questions this presumption.

CSA believes that education as to the scope and application of directors' duties under the *Corporations Act* rather than legislative clarification via amendment will alleviate concern that the current law may prevent companies from taking into account stakeholder interests.

[15] Cowley, B, 'Can directors be personally liable for being too generous in compensating victims?', *Keeping good companies*, Vol 57, No 1, p 36

[16] ibid, p 37

(b) If so, is there any useful scope for clarifying the current law in this respect and does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision making?

CSA does *not* believe that revisions are required to the legal framework, particularly to the *Corporations Act*, to enable or encourage incorporated entities or directors to have regard to the interests of stakeholders other than shareholders and the broader community.

CSA believes that the debate generated by both the CAMAC discussion paper and the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility is fundamental to clarifying the current law. It will allow both companies and their stakeholders to understand that companies are not prevented by the *Corporations Act* from taking into account the interests of stakeholders other than shareholders.

Indeed, CSA is firmly of the view that any legislative clarification of the current law would create the very problems such clarification could seek to ameliorate. If the law is changed, it may mean that directors become less accountable (they are stewards of other people's money and have fiduciary responsibilities to the company), because their duties becomes generalised. The dilution of accountability would make it harder for shareholders and regulators to hold directors responsible for their decisions.

Companies and stakeholders alike should be reminded that CSR can be tailored to suit the company's circumstances by providing for it in the company's constitution. A clause can be included in a company's constitution permitting directors to take account of the interests of stakeholders other than shareholders, for example, 'for any purpose that the board sees fit'. CAMAC may wish to explore the possibility of exploring the inclusion of such a provision as a replaceable rule in the *Corporations Act*. Shareholders would decide whether they wanted it, or a revised version of it, as an object in the constitution. This would involve shareholders in the debate on CSR and enhance community education on this subject. The involvement of shareholders in such discussions would also ensure that they are actively involved in the decision making as to the importance placed on long-term interests in the corporations they invest in.

(c) Are any changes needed to give the current law regarding the right of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?

Currently the law requires 100 members to place resolutions before shareholders at a general meeting. From experience there have been few such resolutions, although it is clear from recent experience that they are increasing in number.

However, it is important to note that many of these resolutions have been submitted by special interest groups with little relevance or interest to the bulk of shareholders, retail or institutional. We believe that the requirement that such resolutions should be submitted by at least 100 members should be retained without reduction, as this represents a fair measure of support that the matter deserves to be discussed at an AGM. We believe that any changes to this latter requirement could see a proliferation of minor, irrelevant, vested-interest issues being included on the agendas of general meetings. This would only serve to make AGMs larger and longer, and would not necessarily serve the interests of the majority of shareholders.

CSA is not of the view that environmental or social concerns are irrelevant. These are issues that may be raised, and frequently are raised during questions at general meetings. They may be the subject of a resolution if 100 members or members with at least five per cent of the votes believe the issues to be important. CSA is of the view that, if less than 100 shareholders find the issue requires a resolution at a general meeting, then it is not possible to claim that the issue has a fair measure of support.

CSA notes that the Corporations Amendment Bill 2006 may or may not amend this provision. At the time of writing, the Bill had not yet been released.

Section 3.4

Should the *Corporations Act* be revised 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, or revised to *require* directors to take such interests into account?

CSA believes that those companies that ignore the long-term impact of social and environmental issues and that refuse to participate in a dialogue with their stakeholders are putting their long-term futures at risk. Such behaviour does not necessarily fit the legal requirement for directors to exercise their power in the best interests of the company.

CSA also believes that performance pressures will encourage companies to have regard for the interests of stakeholders other than shareholders and that this does not need to be legislated. Indeed, if it were to be mandated, having regard for stakeholder interests other than shareholders would likely become a compliance-driven, box-ticking exercise, rather than an innovative, value-creating opportunity to improve performance.

As noted earlier, CSA believes that the law as it stands *accommodates* a regard for stakeholders other than shareholders, which in turn provides for directors and companies to reveal through their activities how capable they are of generating the value-creating opportunities as a result of engagement with stakeholders. Education, fuelled by the public discussion generated by both the PJC inquiry and the CAMAC paper, will help clarify the extent to which directors can take the interests of stakeholders other than shareholders into account.

The public discussion to date has revolved around whether a permissive clause (permitting directors to take account of the interests of stakeholders other than shareholders), or a positive clause (requiring directors to take account of the interests of stakeholders other than shareholders) is needed in the *Corporations Act*. CSA does not believe that either is required.

In particular, CSA is strongly opposed to the idea of a positive requirement for directors to take into account the interests of stakeholders other than shareholders. As noted in the report of the UK Hampel Committee on *Corporate Governance* in 1997, '…the directors are responsible *for relations with* the stakeholders; but they are accountable *to* the shareholders. This is not simply a technical point. From a practical point of view, to redefine the directors' responsibilities in terms of the stakeholders would mean identifying the various stakeholder groups; and deciding the nature and extent of the directors' responsibility to each. That result would be that the directors were not effectively accountable to anyone since there would be no clear yardstick for judging their performance. This is a recipe neither for good governance nor for corporate success.'[17]

[17] American Law Institute, *Principle of Corporate Governance: Analysis and recommendations*, Vol 1, American Law Institute Publishers, 1994, p 46

Furthermore, CSA believes it would be fraught with danger for legislation to include a ‘shopping list’ of stakeholders by listing specific classes of stakeholders. Specific classes of stakeholders can change with time, according to the stage of growth and the industry sector applicable to a company. Legislation would not keep abreast of these changes that mark the organic life of a company.

As noted earlier, a clause can be included in a company’s constitution permitting directors to take account of the interests of stakeholders other than shareholders, for example, ‘for any purpose that the board sees fit’. CAMAC may wish to explore the possibility of exploring the inclusion of such a provision as a replaceable rule in the *Corporations Act*.

Section 4.8

(a) Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities?

A new section, s 299(1)(f), was introduced into the Corporations Law by the *Company Law Review Act 1998* (Cth). The first year of reporting was the 1998/99 financial year. The number of companies reporting on their environmental performance where their performance is subject to environmental regulation is increasing.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act* 2004 (commonly known as CLERP 9) commenced on 1 July 2004. It contains 13 schedules containing amendments to the *Corporations Act* and the *ASIC Act*. The financial reporting schedule (Schedule 2) deals with CEO and CFO declaration, management discussion and analysis (MD&A) and the new Financial Reporting Panel. The MD&A requirement is set out in the new s 299A. This section ensures that a listed public company directors' report includes information that members would reasonably require to make an informed assessment of the company's operations, financial position, business strategies and prospects. This reporting requirement accommodates non-financial reporting, including disclosure of the environmental and social impact of corporate activities.

Under ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed the best practice recommendations in the last financial reporting period, including Recommendation 10.1 noting that companies should establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

CSA does not believe that any changes are needed to current statutory requirements to ensure better disclosure of the environmental and social impact of corporate activities.

(b) Are any changes desirable to any other reporting requirements, such as the ASX Listing Rule requirements, the ASX Corporate Governance Council Principles or relevant accounting standards, to provide more relevant non-financial information to the market?

The ASX Corporate Governance Council has responded to Senator Ian Campbell’s request that it consider the issue of non-financial reporting for listed companies. The Council has agreed that it has an educative role to play in enhancing understanding of non-financial/CSR reporting, what it may cover, what investors are seeking from such information and the benefits to companies of such reporting.

The Council's great strength is that, as it is composed of 21 industry groups, the process of arriving at the *Principles of Good Corporate Governance and Best Practice Recommendations* was consultative and consensus-based. Hence the Principles achieved 'ownership' by the parties affected by them when they were issued. The Principles are also supported by the Listing Rules.

Given this consultative and consensus-based approach, the Council can play an important role in educating the corporate community and assisting the public discussion of what form non-financial/CSR reporting might take. It would be premature to pre-empt the Council's final recommendations on this issue, when it has resolved to issue a discussion paper for consultation in 2006.

(c) In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form?

It would be premature to pre-empt a decision as to the form and style of any non-financial/CSR reporting at this time. CSA believes that the debate generated by the CAMAC discussion paper, the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility and the proposed ASX Corporate Governance Council discussion paper on non-financial/CSR reporting are fundamental to clarifying how CSR information might be reported, according to industry sector and size of company.

(d) It is possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles?

It would be premature to pre-empt a decision as to the form and style of any non-financial/CSR reporting at this time. CSA believes that the debate generated by the CAMAC discussion paper, the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility and the proposed ASX Corporate Governance Council discussion paper on non-financial/CSR reporting are fundamental to clarifying how CSR information might be reported, according to industry sector and size of company.

(e) Would an additional environmental or social 'impact' reporting obligation be appropriate and feasible and, if so, how might it be stated?

CSA firmly believes that mandating an additional environmental or social 'impact' reporting obligation would be counter productive. The content of any such report will differ across industries and companies. Mandating such a report leads to the very real possibility of 'greenwash' reporting and public relations spin, as companies tick boxes against obligatory content that may have no relevance to their activities.

Underpinning this is the even more serious possibility of the development of a negative culture in relation to non-financial/CSR reporting. If a company is obliged to report against content that has no meaning for it, the company will not value its reporting. A desired culture is one where the board of directors and the management team are making active decisions as to the company's activities in its sphere of commercial activity, with full consideration given to the environmental and social impacts of each decision. This process can then be reported. Asking companies to report against mandated content works against the development of such a culture.

Also, CSA has already noted that those companies alert to the long-term impact of social issues and in a constant dialogue with their stakeholders have a competitive advantage. Shifts in social issues that ultimately feed into the fundamental drivers of corporate performance generate value-creation opportunities. Retaining a competitive advantage is about managing exposures over the long term. If non-financial/CSR reporting becomes solely a compliance exercise, it removes the incentive for corporations to compete with one another and seek investment on the basis of being ‘ahead of the game’.

Furthermore, there is the question of what ‘useful’ information should be made available to stakeholders. Given the diversity of stakeholders, it is not surprising that they often have different and conflicting opinions as to what information is relevant. Different audiences want different information for different purposes. If a mandated reporting obligation were to be introduced, the attendant preoccupation with legal compliance and the reliability of the information would not automatically translate into a focus on the usefulness or relevance of information.

Section 5.7

(a) To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?

It is salutary to compare voluntary initiatives in CSR now with what was happening only 10 or 15 years ago. There has been a dramatic, positive shift in CSR reporting, which was not mandated or regulated. The important point in noting this voluntary shift to embracing CSR approaches and strategies (and the reporting of same) is that it was an organic, evolutionary process rather than an imposed one. As such, it generated experiential learning that embedded the value of CSR in the culture of those companies that underwent the process. The learning took place in confronting the challenges and problems that arose on the journey. The process was not viewed as an obligatory one with punitive strictures attached to not following a mandated structure.

It was a voluntary process because companies saw the value in embracing CSR approaches and strategies. Over time new issues that cannot be identified today will emerge and those companies with a culture of ‘looking outside the square’ and actively identifying risks will be best placed to engage with those issues. If companies are concentrating on reporting against a shopping list of issues, such a culture is unlikely to be fostered.

For example, in 2005 BHP Billiton spent one per cent of pre-taxation profit on community programs and its shareholders supported this expenditure. BHP Billiton embarked on a journey of embracing CSR voluntarily and understands that engagement with stakeholders and regard to the environmental and social impacts of its activities goes to the heart of its licence to operate. The competitive advantage for the long term has been demonstrated and now many companies in the extractive industry take into account the interests of stakeholders other than shareholders. As one company innovates in this regard, others follow. This is how a cultural shift takes place.

BHP Billiton has also adopted a Matched Giving Program, where contributions of time or money by employees to community and charitable organisations are matched by the company. As noted earlier, Zurich Financial Services Australia Limited runs Community Connections. The program supports and encourages employees to engage with the community through the donation of their time and money. CSA notes that the Federal Government has facilitated the donations by employees to charitable institutions by providing for an immediate tax deduction, rather than asking employees to wait to receive the deduction.

(b) What lessons might be derived from any experience with voluntary initiatives?

The main lesson that has been derived from experiences with voluntary initiatives is how they embed a culture of CSR in a company.

By making CSR part of the normal business process, through embedding it in business decision making, the performance measurement system, employee and management incentive programs and the business planning process, CSR has a long-term effect on the company's culture.

Those companies that have undertaken voluntary initiatives have engaged in a process that allows them to:

- understand the range of stakeholders (and their relative priority) and identify their key issues in terms of both risks and opportunities
- audit the range of activities that already exist within the business
- decide where the company wants to position the business in terms of its CSR approach compared to those of its competitors and peers
- involve management and employees, both at the centre and in the operational business units, to determine the focused range of activities to which the company should be committed
- develop a CSR management system so that CSR becomes integrated within the business rather than being an add-on, or standing to one side (for example, as a compliance issue dealt with by the compliance division).

Ongoing public debate and discussion and education as to the benefits being derived by those companies that have embraced a CSR approach will assist those companies not yet fully aligned with the issues.

Tim Heesh
Pymble NSW 2073
Ph 02 92332111
Email: tim@jirsch.com.au

Attention: Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee (CAMAC)
GPO Box 3967
Sydney NSW 2001
21 February 2006

By email john.kluver@camac.gov.au

Dear CAMAC

CAMAC: CORPORATE SOCIAL RESPONSIBILITY – Tim Heesh Submission

Thankyou for providing the opportunity to respond to the CAMAC Discussion Paper.

I have been a Chartered Accountant since 1986. I am on the advisory management committee to the Institute of Chartered Accountants In Australia on matters relating to Triple Bottom Line Reporting and Broad Based Corporate Reporting. I am a director of EcoSTEPS Pty Limited, a multi-disciplinary consultancy which specialises in Sustainability and Triple Bottom Line strategies and practices. I am a director and secretary for the Australian Institute of Social and Ethical Accountability Incorporated a membership organisation set-up to support and promote organisational accountability. I have been a registered liquidator and currently I am a principal and business development manager with the Chartered Accounting firm Jirsch Sutherland in Sydney.

I make this submission under my own name and all of the opinions and comments are mine and mine alone.

Because of my involvement in the area of 'corporate social responsibility' and my long career working as a chartered accountant with a heavy interaction with the Corporations Act I believe I am well placed to provide comment and input to the CAMAC discussion paper.

I respond below to each of the questions raised at the end of each section in the discussion paper. Firstly however I summarise the main points of my response:

Main points in response to issues and questions raised in the Discussion Paper

1. Corporations act in accordance with the traditional financial risk/ return dynamic. Voluntary CSR initiatives will only ever be adopted by corporations if the risk/ return dynamic for the initiatives are satisfactory. Corporations make decisions based on short-term pay-back periods and therefore neglect the long-term consequences of their organisations operations. Because these drivers dictate the way organisations operate many issues about the long-term health of the earth's natural systems and other externalities are ignored. For example, there is no adequate price allocated to air, water, waste, pollution, emissions etc. to protect and maintain these natural systems. If organisations won't adequately share in the protection and maintenance of things such as the natural systems in a voluntary way then they should be regulated to do so.
2. However before regulations are developed and introduced to influence the way corporations deal with their externalities, the regulator needs to know what areas require regulation. In order to find that out corporations should be forced to produce and capture TBL information and produce regular TBL reports. To facilitate that the Global Reporting Initiative should be compulsorily adopted by corporations meeting certain profiles as the standard TBL reporting framework.

3. Verification of TBL reporting should also be introduced at the same time. The stakeholder based assurance standard AA1000SES should be adopted to meet that requirement.

*   *   *

I would welcome the opportunity to discuss any or all of the maters raised in this submission with CAMAC. I am happy for this submission to be publicly available.

In the first instance, please contact me on 02 9233 2111 or tim@jirsch.com.au

Yours sincerely

Tim Heesh

Tim Heesh

Submission to

CORPORATIONS AND MARKETS ADVISORY COMMITTEE (CAMAC)

CORPORATE SOCIAL RESPONSIBILITY

February 2006

Introduction

The area described as Corporate Social Responsibility (CSR) as addressed in the CAMAC discussion paper is, in my opinion, an appropriate area for the federal government to review in connection with possible amendments to the Corporations Act.

The Corporation has proved to be a very successful legal vehicle in providing goods and services for communities and societies on a range of scales for the last couple of centuries.

Corporations have also been at the forefront of buying and selling their supplies and goods and services with an increasingly globalised outlook and approach. The Globalisation of the 21st century is a different trading regime to the global trading regimes of years gone by. Communications and transportation efficiencies have left no corner of the world untouchable. Every populated region is now a market for savvy business managers to supply their wares and reap the associated rewards.

One of the consequences of this phenomenon is that corporations now operate in many different countries and under many different legislative regimes. The laws of the country of origin are but one set of laws those organisations must now work within.

Another consequence of the rapid globalisation of the economies of the world is that more and more people around the world are accessing the modern trappings of the developed countries of the 21st Century. These trappings have come to represent a proxy for wealth and a societies well being. The flip side of this is that modern industrialised societies are consuming the world's resources at a rate never reached before today. Some of these resources are being renewed, most however are not. Along with the great consumption of non renewable resources is the increasing degree of waste that is a by product of modern industrialised economies.

The modern globalised economy is not about to slow down in its relentless march towards greater and larger economic growth. The two largest populated countries on the earth, China and India, have embraced the industrialised approach to economic growth (and by default acceptance of that as a proxy for wealth and societies well being) and are growing (economically) at unprecedented levels. All significant economic statistics point to a greater and greater demand for the earths resources. All other industrialised economies are delighted with the great wealth they are now enjoying because of these two countries (and others) demand for goods and services.

It is not hard to hypothesis that the continued growth of these two economies along with the rest of the world will place an unprecedented demand on the world's resources and the earth's capacity to deal with the resultant wastes.

It is clear that corporations of the 21st century face different challenges than previously confronted. Governments of the day need to recognise that societies all round the world are developing more intricate trading relationships and the management of the world's resources and its wastes need to change to keep pace with the changing economic landscape. Tools are constantly being developed to meet these demands however due to the vagaries of market economies, governments need to monitor corporation's responsiveness to these Corporate Social Responsibility (CSR) issues and where appropriate, legislate to ensure corporations comply with the government's expectations in this area which in turn should be a reflection of society's expectations.

Short-Termism, Corporation Limitations & Capital Markets

Governments need to recognise the limitations of corporations in their desire to operate in a manner that takes this very complex globalisation into account. Corporations have always operated to create wealth for their owners. It is hard to imagine an alternative equally successful legal vehicle to achieve this end moving forward. Corporations are essentially dictated by the objective of constantly maximising the profit (bottom line). Managers of corporations are rewarded and incentivised, not by how they minimise the impacts the corporation is having on negative externalities (environmental & social impacts) but rather the profit that can be generated in short time frames generally of 1, 2 and 3 year periods.

Corporations and the personnel that run them are constantly encouraged to develop strategies that generate satisfactory profits over relatively short time horizons. This in turn provides a disincentive for corporations to look far into the future as to its long term viability. Capital markets participants do not generally place a premium on capital that is tied up in long term projects such as the long term survival of the corporation. Reason being is that capital market participants also like results that crystallise in short time frames as they to be rewarded accordingly.

Capital markets also don't generally price a premium on corporations who manage their Triple Bottom Line (TBL) better than others. There is little evidence that the capital markets rely upon that demonstrates that a well managed corporation with respect to its TBL should enjoy a premium for managing that risk well.

In summary because there is very little incentive for corporations to manage their TBL's to maximise the prospect of a sustainable future there can be little confidence that corporations will 'do the right thing' by society unless it is in their financial interest to do so.

Given the capital markets do not place much value on the management of these risks, coupled with the short term approaches inherent in managers strategies along with that of capital market participants, there is little prospect that corporations will voluntarily adopt TBL or CSR approaches without some effective encouragement.

Legislative Encouragement

In that respect corporations will eventually need legislative encouragement to operate in a manner that acknowledges their role in the utilisation and distribution of the earth's scarce resources and the resulting production of wastes into the 'common' of the earth's societies and other living species and ecosystems.

To put it as bluntly as possible, corporations will not have the collective will, desire or official mandate to take into account the well being of the planet if left entirely to their own voluntary 'corporate socially responsible' initiatives. Corporations will need official (legislative) guidelines to ensure that the government's responsibility to the society at large is being factored into corporations operations both locally and overseas.

It is certainly not before time that the federal government turns its attention to this area. Whether Australian Corporations are presently ready or not for some legislative endeavours in the area the government has tagged as Corporate Social Responsibility is not the real issue. The real issue is that this area needs to be for ever more under the review of the government. The world has changed dramatically as have the way corporations operate. The legislation has to change with the times to ensure the best interests of society are being considered.

With that as backdrop to my submission in response to the discussion paper I now address the specific issues raised.

THE ISSUE OF CORPORATE SOCIAL RESPONSIBILITY

1. How might corporate social responsibility usefully be described for working purposes?

The term corporate social responsibility has been around for some time now, probably gaining some traction during the 1990's. It is however not a term that is universally adopted and as the discussion paper points out, is not universally understood. I believe it is a term that currently has no clear definition however if CAMAC require a title to discuss the issues as raised in the discussion paper then CSR is probably as good as any other.

I think that as a rule of thumb what CSR (ie CAMACS generic heading for this area) is all about is a corporations understanding and approach to the impacts of its operations that are not traditionally dealt with in existing legislation. That is, corporations are governed by the corporation's law, listing requirements (if listed) and some other specific legislation. These frameworks define the responsibilities of the corporation and therefore the framework that boards of directors must make their decisions within. Corporations however, through their operations impact upon many different stakeholders and environments which are not specifically dealt with by these legislative frameworks. CSR is all about how corporations deal with the areas of impacts that are not regulated by the existing legislation. These areas have become known as 'externalities' and have been more recently grouped under the TBL categories of Environment, Social and Economic externalities.

To answer CAMAC's question "…..How might corporate social responsibility be usefully described for working purposes?**....."** I believe CSR should simply be described as the corporations approach to the social, environmental and economic impacts of its activities.

2. Which approach or combination of approaches to responsible corporate behaviour is most appropriate?

The notion of 'responsible corporate behaviour' is extremely misleading. Historically, all companies would consider they have conducted their affairs in a responsible corporate manner. That is, they obey the laws of the land whilst attempting to maximise wealth creation for their owners.

Some companies have developed strategies that could be construed as being philanthropic, whilst others have developed strategies that have some positive social, environmental or economic outcome. The traditional company complies with the law and states because it is a good complier of the law (eg complies with the spirit of the law) it is a good corporate citizen.

All these companies develop their responsible corporate behaviour with the bottom line in mind. It is therefore misleading to suggest that corporations are adopting a responsible corporate approach for the stakeholders that will benefit from their actions. They are doing it because it will improve shareholder wealth.

I site as an example the Westpac Banking Corporation. The company is acknowledged as one of the leading corporations in the CSR field , however its motivation is the improvement of its bottom line, not the betterment of society. Naturally it is happy to achieve both a good bottom line and some positive outcomes for some of its stakeholders .

As such 'voluntary' corporate behaviour is exactly that, voluntary and can never be legislated for. The legislator need to turn its attention to regulating something that it will have power over. A regulator cannot have power over voluntary initiatives that are designed to improve the company's bottom line as corporations are always looking for ways to do that.

3. What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

This question cannot be answered definitively. There are numerous ways a corporation will be incentivised to conduct its business in a socially responsible manner just as there are many disincentives. A corporation will find out what best works for it and adopt strategies accordingly. Legislation will not be necessary to force a company to adopt a strategy that will create profits for itself inline with its accepted rates of return on investment.

It seems that a more useful way in which to consider the issue of CSR is by acknowledging that CSR initiatives can arise from two separate platforms. It can either be voluntary or involuntary. A voluntary initiative will be introduced where it is acknowledged an acceptable rate of return can be earned from the investment made. An involuntary initiative is one where the corporation would not have undertaken it except it was forced to. Ie the cost of not doing it outweighed the cost of doing it. This can easily be brought under the umbrella of legislative initiatives

It also seems that the real issue with the legislator considering the area of CSR, is whether it is prepared to force companies to undertake CSR initiatives that cannot be easily demonstrated to generate an acceptable rate of return.

4. Do different or additional implications arise depending on the nature or size of the enterprise, for instance:

- **The sector or industry in which an organisation operates?**
- **Whether a company has international operations?**

Clearly, the nature and size of an enterprise matters. Both the nature and size will produce different externality impacts. If a company has international operations that too will create different externality characteristics.

The answers to these questions seem to be self evident.

The real issue here is in respect of impact. The size, location and activities of corporations will be the significant factors in delivering the externality (TBL) impacts. The larger the operations the more likely the impacts are going to be greater. Larger corporations will impact more people, utilise more resources, create more wastes and generally wield more influence than smaller corporations.

This fact needs to be factored in when considering how best to incorporate CSR initiatives into a corporations operations.

5. In practice:

- **to what extent is corporate decision-making driven by stakeholder concerns?**
- **How do companies differentiate between different categories of stakeholders?**
- **In what ways do companies balance or prioritise competing stakeholder interests?**
- **How do companies engage with stakeholders?**

Corporations take into account the interests of stakeholders only where they are legally obliged to, where the financial risk of not doing so is so high as to impact upon the financial returns to shareholders, or where it is going to provide a positive financial return to the shareholders by taking the stakeholders interest into account.

Companies differentiate between stakeholders by the law, and by a risk/ return assessment of the stakeholders.

Corporations balance or prioritise competing stakeholder interests by measuring the risk/return equation of each and categorising each accordingly.

Corporations engage in any way which meets their strategic objectives.

6. In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company?

Without analysing each major common group of stakeholders it would be fair to say that unless there is legislative requirement to take into account corporations CSR then there is little incentive to do so. Certainly there are 'green consumer' products developed for those people who feel strongly about these issues but overall there are few materially effective stakeholder groups that force corporations to change the way they do things.

The recent legislative changes that force funds managers to consider the social & environmental issues is an example where stakeholders have been forced to take into account CSR type issues. It is early days and there is not a lot of research done to know what impact this legislation's having.

Certainly Socially Responsible Investors (SRI's) consider CSR performance as do some government procurement practices but overall these stakeholder considerations are sparse and inconsistent.

7. Are there any changes that could enhance triple bottom line, sustainability or like reporting, including:

- **Increasing the level of clarity and comparability of these reports?**
- **Any suggested changes to external verification of these reports?**
-

This is a difficult question to answer presently. TBL reports have only been present since the 1990's. There are a variety of models and presentations although certainly the Global Reporting Initiative seems to have attracted a lot of attention by those corporations that are reporting or considering reporting.

Even though the reporting area is in its infancy that should not be an impediment to its adoption by corporations. Like financial accounting it will become more robust over time and consequently more reliable. Comparability may not necessarily be the big issue between corporations. Possibly a more helpful criteria is whether the individual corporations consistently report their TBL results from period to period. Sustainability indicators and the resultant reports are about continual improvement. The best measure of improvement is a comparison of the organisations progress from period to period, not necessarily what its competitors are up to although one can see when that too would be useful.

The only true way to get comparability between corporations is via regulation and legislation. Left to voluntary mechanisms adoption of a standard approach could be a very long time in the making.

With respect to external verification the first point to make is that it is absolutely fundamental to have a TBL report verified. Without verification its worth as a reliable document must come under question. The actual verification process is also evolving as it too has only been round since the TBL reports were developed. Unlike financial verification, TBL verification gets its leads, benchmarks and materiality levels from the corporation's stakeholders and measures of externality impact. Consequently it will take time for corporations to absorb a true feel and understanding of the TBL and verification process.

With respect to the question, any suggested changes to external verification of these reports, there is certainly a requirement to develop standards and approaches that are consistently applied along with accreditation of the verifiers. That is an area that requires greater consideration

- **Whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s)?**

Reporting should be mandated however it will not be useful for all companies.
As noted above size, location and type of operation all influence the importance of a TBL report and TBL initiatives.

The issue therefore is not so much should TBL be mandated but how to decide what companies need to report.

One is tempted to state that the criteria should not necessarily be dollar based as that is not always a good proxy for TBL impacts. However there are good rationale for considering dollar value as an appropriate starting point. Firstly, it is easily determined. Eg Income, Capitalisation, Expenditure, Asset Values. Secondly, generally larger companies on financial measures are the ones with the greater impacts and certainly influence.

TBL reporting, like financial accounting is not only helpful in identifying material items but also identifying areas that are immaterial. For example, in financial accounting all companies must report upon non current assets such as plant and equipment. It matters not that the assets may contribute only a minute value to the assets on the balance sheet. Readers of the financial statements then know that plant and equipment are not relevant to the company The same philosophy applies with items like tax or liabilities such as secured loans. The issue is disclosure and making the user aware of the materiality of the item.

The same approach is important for TBL reporting. Users will need to know what areas are not materially significant just as much as those areas that are of material significance.

-Are there particular issues for small to medium enterprises?

Yes, however the government should focus on the larger corporations first as they have the greater impacts.

DIRECTORS' DUTIES: CURRENT POSITION

8. **Whether, or in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions?**

9. **If so, is there any useful scope for clarifying the current law in this respect?**

10. **Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision making?**

11. **Are any changes needed to the current law regarding the right of shareholders to express their view by resolution at general meetings on matters of environmental concern?**

12. **If you have any proposal for change, how might it be implemented and work in practice and how might directors be held to account?**

Directors have essentially two responsibilities:

1. to manage a corporations affairs in accordance with the law
2. maximise shareholder wealth

As noted above, directors will initiate 'CSR' strategies if it assists in maximising shareholder wealth. CSR initiatives are unlikely to be illegal and so directors will meet both responsibilities if they believe it is worthwhile to do so.

Consequently, there is no real reason to consider a law change to assist directors in taking into account stakeholders interests etc.

As noted above, the capital markets are focussed on short term results in the delivery of shareholder wealth. If corporations cannot provide desired levels of wealth creation activities within timeframes acceptable to the market place then the market will allocate its investment dollars to assets that are projected to provide the required rate of return within the accepted timeframe.

This is a definite impediment to directors introducing strategies that are predicted to produce adequate returns on the resources invested but may not have a pay back period that meets the capital markets timeframes. Likewise the expenditure of a corporations resources in trying to mitigate risks that it faces through its operations (eg greenhouse gases) into the future will not get the support of the capital markets if that risk is unquantified (or unquantifiable) and difficult to predict when it might impact on the corporations operations.

As a supporter of increased CSR (TBL) initiatives for corporations to undertake, the short-term outlook of capital markets needs to change if CSR limitations are to occur at the level necessary for the corporations to become sustainable into the long-term future.

Because the voluntary approach to CSR is unlikely to achieve this objective in the foreseeable future there appears little alternative at this stage other than to make mandatory certain CSR/TBL type activities for corporations that generate material negative impacts in these TBL areas through their operations.

Obvious examples are industries that have high energy and water uses along with industries that have large ecological and social footprints such as Aluminium production, Manufacturing, Livestock Breeding etc

In that respect it maybe appropriate for the commission to consider 'foot printing' methodologies and TBL/sustainability reporting as first areas that requires regulation. Clearly, corporations and directors need to know what the impacts are before initiatives and strategies can be introduced to minimise the negative impacts of those operations. Once something like mandatory reporting (and assurance) has been introduced, the regulator will then be in a stronger position to identify the areas that need addressing.

It is understood that the market place, and certainly all of the peak industry groups will strenuously fight the introduction of mandatory reporting and any subsequent changes to their operation arising from future regulation of externalities however it is clear the market place will not allocate resources to manage the externalities to the level required by society moving forward. This is a definite case for government to step in and regulate. That is what government is for.

With respect to changes to the laws for directors to be able to take other stakeholders interests into account, there is no immediate necessity to legislate if the government introduces reporting regulations as noted here as the directors will be duty bound to run the corporation within the laws that they are governed by.

DIRECTORS' DUTIES: MATTERS FOR CONSIDERATION

13. Should the Corporations Act be revised 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?

At the present time the committee should be considering mandatory TBL/Sustainability reporting of corporations of certain size and in certain high impact industries. Once in place other regulations can be considered that will take into account the specific interests of different classes of stakeholders and also environmental and economic impacts.

This is not so much clarification for directors but simply the introduction of mandatory reporting which in its own right will clarify director's responsibilities for reporting CSR/TBL. At this stage the GRI would be one of the front runners for a reporting framework to be considered by the committee. At the very least immediate and extensive studies should be undertaken to identify reporting frameworks that would best suit the Australian corporate landscape.

Once regulations are introduced to manage corporation's externalities directors will again have a better idea of what responsibilities they have to stakeholders other than shareholders.

14. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

See above comments as they are just as valid for this question.

15. Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other approach to directors' duties?

See above comments as they are just as valid for this question.

16. Would any suggested change be intended to go beyond the current law or would it be intended as clarification only?

See above comments as they are just as valid for this question.

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17. If a pluralist approach were to be adopted:

- **should directors be permitted to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions, or alternatively**
- **should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions**
- **In either case what broader interests should be identified?**

See above comments as they are just as valid for this question. In addition to those comments the committee should note that reporting frameworks such as the GRI clarify quite well the areas that stakeholders are usually interested in and after reporting has been mandated a sense of the major areas that stakeholders require attention will emerge and the regulator can then turn its attention to the appropriate regulations at that time. A time horizon of 4 to 5 years seems like the appropriate time frame.

It is the writer's opinion that a pluralist approach is needed in that directors will eventually be obliged to take into account the interests of certain stakeholders/ environment. This can be regulated after mandatory reporting has produced information which highlights the areas of greatest materiality with respect to the corporation's externality impacts.

Until that occurs it is premature to try and determine what stakeholders etc directors should have to take into account.

The argument that directors will end up having a confused understanding as to their responsibility to shareholders if they have to take into account the interests of shareholders is ludicrous. The first step is getting an understanding of external impacts which is currently not available. The next step is to identify which of those externalities requires regulation with respect to how the corporation deals with it in its own operations.

If the corporation is forced to outlay funds due to the regulation which inturn results in a lower profit to shareholders than would otherwise be the case then so be it. This has to be the position because to ignore externalities because there is an unsatisfactory commercial pay back places little value on the negative impacts the corporation is having on society and the environment. Left unchecked the results could be disastrous for society. The government needs to step into these situations and corporations who cannot make adequate returns after taking into account the appropriate mandatory care of their external negative impacts should not be allowed to operate as they are reducing the public's social and environmental capital. These corporations are earning a profit for a small group of investors at the expense of society and the environment. Naturally, an equitable transition policy and program would need to be developed and implemented to compensate investors to ensure there would be no major financial losers. This is a cost society (i.e. the government treasury) which would have to be funded to achieve this end.

- **How might any proposed amendment be implemented and enforced?**

See above.

18. If an elaborated shareholder benefit approach were to be adopted:

- **What form should it take?**
- **Would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments?**
- **How might any proposed amendment be implemented and enforced?**

See comments above however the committee should seriously consider the UK Company Law Reform Bill after introducing mandatory reporting. The UK provisions could be the model to follow with respect to introducing regulations to address the reduction of negative impact externalities.

CORPORATE REPORTING

19. Are any changes to current statutory requirements needed to ensure better disclosure of the environmental or social impact of corporate activities?

Yes. See comments above with respect to the mandatory introduction of TBL/Sustainability reporting and assurance. The current laws are totally inadequate in this respect.

20. Are any changes desirable to any other reporting requirements, such as the ASX Listing Rule requirements, the ASX Corporate Governance Principles or relevant accounting standards, to provide more relevant non-financial information to the market?

The first requirement is to introduce some form of mandatory TBL reporting through the corporation's law for companies of certain size and involved in certain high TBL impact industries. If that is done then no amendment to ASX listing and governance requirements will be necessary in the short term.

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21. In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form?

This is a difficult question to answer at this stage in the development of TBL/Sustainability reporting. Clearly, quantitative is more attractive however some areas do not lend themselves to quantitative representation. At this stage the committee should consider the existing reporting TBL frameworks and let them evolve . Should it be determined over time that certain requirements of a reporting framework such as GRI are not suitable in meeting the objectives of the law then certain amendments should be made to reflect that position

22. Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles?

Yes, it is possible to specify certain criteria, but it is not favoured, due to the fact that there is such diversity between businesses and their social impacts.

23. Would an additional impact 'environmental or social 'reporting obligation' be appropriate and feasible and, if so, how might it be stated?

Yes, for all of the reasons noted above.

How it should be stated could be by stating that corporations that meet certain criteria (size, type of operation, industry etc) will need to provide TBL/sustainability report on the same reporting timetable as the corporations financial year end. The committee will have to define the type of reporting framework to adopt.

ENCOURAGING RESPONSIBLE BUSINESS PRACTICES

24. To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?

Hard to know as not all corporations report on their voluntary initiatives however one must assume that there is possibly some improvement based on those corporations that have adopted voluntary reporting.

25. What lessons may be derived from any experience with voluntary initiatives?

The primary lesson is that corporations will only embark upon voluntary initiatives if they think it will add value to the corporation. It is clear than many corporations still do not even see the benefit from voluntary initiatives and the corporations that do will only support an initiative that can provide a commercial payback.

It has to be said that the voluntary approach is inherently flawed as it won't take the interests of society of the environment into account unless it also assists shareholder value. Clearly there is a conflict in many instances and society and the environment will lose out each time.

Globalisation has generated huge multi national organisations that control huge resources and have great influence on many stakeholders that deal with them. Many stakeholders have little choice in dealing with them due to the nature of their operations. If a voluntary initiative is not in the corporation's best interest then it will not be undertaken. It may however be very/extremely important from societies or the environments perspective. This is where the government needs to regulate to give these stakeholders and the environment a seat at the decision table.

26. What would be the nature of any proposed initiative,

27. What would be its intended purpose and consequences

28. How might it be implemented and

29. What would be its costs and other implications?

The committee will note that the above submission does not recommend the support of voluntary initiatives, rather mandatory requirements of corporations need to be considered and hopefully introduced. Corporations will always adopt voluntary initiatives the directors project will improve their bottom line.

If the business community (primarily represented by peak business bodies trying to demonstrate some useful purpose to their existence to their subscription paying members) present the arguments (which they will and already have) that business is voluntarily adopting CSR approaches and practices and as such is already taking into account a large range of stakeholders interests other than the shareholders then regulation should not be a problem. That is, regulation of existing practices, all things being equal, is simply codifying existing practices. The introduction of mandatory reporting should not be an issue as corporations that are doing it voluntarily will see no change to their existing cost structures. Organisations that are not presently reporting cannot stand back and say regulation is not warranted if they can't demonstrate that their operations are not creating material negative TBL impacts. You see you can't have it both ways. Either it's done voluntarily, and it's done by all or you regulate it so it is done by all. Business can no longer hide behind the voluntary adoption argument as it is flawed and riddled with self interest and therefore conflict of interest.

Regulation to introduce mandatory TBL/Sustainability/CSR reporting is absolutely necessary and should be introduced without delay.

Tim Heesh
24 February 2006

Law Council
OF AUSTRALIA

From the Office of
the President

JOHN NORTH

Mobile 0413 440 688

president@lawcouncil.asn.au

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 2967
Sydney NSW 2001

Dear Mr Kluver,

CAMAC Discussion Paper *Corporate Social Responsibility*

I have pleasure in enclosing a submission in response to the CAMAC discussion paper on *Corporate Social Responsibility.*

The submission has been prepared by the Insolvency and Reconstruction Law Committee of the Business Law Section of the Law Council of Australia. Please note that this submission has been endorsed by the Business Law Section. Owing to time constraints, the submission has not been considered by the Council of the Law Council of Australia.

If you would like to discuss any issues raised in the submission, please contact Philip Stern on [02] 9253 9999.

Yours sincerely,

Peter Webb
Secretary-General

23 February 2006

Enc.

Submission by the Insolvency and Reconstruction Committee of the Law Council of Australia to the Corporations and Markets Advisory Committee

Corporate Social Responsibility

Discussion Paper

November 2005

For the purpose of this submission, the terms listed below have the following definitions:

> **'insolvency administrator'** includes a receiver, or a receiver and manager of a corporation, an administrator of a corporation, an administrator of a deed of company arrangement executed by the corporation, a liquidator of a corporation, a trustee or other person administering a compromise or arrangement made between the corporation and someone else.

Introduction

1. The Corporations and Markets Advisory Committee ('CAMAC') in the Corporate Social Responsibility ('CSR') Discussion Paper fails to recognise or make any reference to the impact that the matters raised in the Paper may have on the administration of insolvent corporations. The Insolvency and Reconstruction Committee believes this is an important oversight as these matters, if legislated, would have an immense impact on the practice of insolvency as outlined below.

Officer of a corporation

2. While there is no express reference to insolvency administrators in the CAMAC Discussion Paper, by implication the issues raised in the Paper extend to cover such persons since sections 9 and 179 of the Corporations Act 2001 *(Cth)* defines 'officer of a corporation' to include:

2.1 a receiver or receiver and manager of the property of the corporation or a controller; or

2.2 voluntary administrator of the corporation; or

2.3 an administrator of a deed of company arrangement executed by the corporation; or

2.4 a liquidator or provisional liquidator of the corporation

3. As such the matters raised by the CAMAC Discussion Paper have direct impact upon the duties, obligations and liabilities of insolvency administrators.

Principles of Insolvency law

4. Insolvency law is primarily concerned with efficient procedures for the winding up of companies, the orderly realisation of the available assets of companies and the equitable distribution of the proceeds to creditors and shareholders.

5. The Harmer Report considered that the overriding objectives of insolvency law were:

5.1 insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense;

5.2 insolvency administrations should be impartial, efficient and expeditious;

5.3 insolvency law should provide a convenient means of collecting or recovering property that should be applied toward payment of the debts and liabilities of the insolvent person (11 ALRC Report No 45, para 33).

6. In addition to the objectives outlined above, the Insolvency and Reconstruction Committee submits that the objectives of insolvency administrators in performing their function is to:

6.1 protect the interests of creditors and shareholders;

6.2 ensure debts are satisfied and maximise the value of an insolvent company's assets with the minimum of expense and delay.

7. Based on these fundamental principles, it is submitted that the matters raised in the Discussion Paper by CAMAC would impair the objectives and functions of insolvency administrators for the reasons set out below.

Concept of 'stakeholders'

8. The Discussion Paper considers the notion of expanding the current duties under the Corporation Act to include taking into account the interests of 'stakeholders'. As discussed above, sections 180-183 of the Act apply to 'officers' as well as directors. Therefore this proposal extends to potentially affect the duties of insolvency administrators.

9. The Insolvency and Reconstruction Committee submits that if insolvency administrators were required to take into account the interests of stakeholders this would displace their primary function of ensuring the protection of creditors and maximising the recovery of debts owed to them.

10. Additionally, these expanded duties would conflict with the explicit duties of insolvency administrators under the Corporations Act, for example the controller's duty of care in exercising a power of sale pursuant to section 420A of the Act; an administrator's duty to maximise business existence or creditor returns under section 435A.

11. Taking the principles of insolvency into account, it would not be suitable in the administration of a company for an administrator to take into account any other interest aside from the creditors, and in the event of any surplus, the members.

12. It is submitted that if the legislation was amended to expand the duties of directors and other officers, then insolvency administrators should be expressly excluded by the legislation.

Triple bottom line ('TBL')/sustainability reporting

13. The CAMAC Paper discusses TBL reporting which includes the concept of companies publishing information on environmental, social and economic aspects of their company.

14. The Insolvency and Reconstruction Committee submits that to require insolvency administrators to comply with such reporting requirements would instead of providing any useful benefit, only create an increase in costs and delay in the administrative process.

15. Additionally, it is inappropriate for insolvency administrators to be required to report on non-financial and intangible aspects of a company in an insolvency administration, when their expertise is the financial aspects of a company.

16. Further relevant is the situation where a company is still a going concern yet an insolvency administrator has been appointed. He/she may be exposed to the costs of bringing the company's TBL reporting up to date. Further the ongoing costs of maintaining a company's TBL reporting would only act to further drain the company's finances.

17. The Insolvency and Reconstruction Committee submits that should TBL reporting be included in the Corporations Act as a mandatory requirement, an express exemption should be made for insolvency administrators as such reporting would be an expensive and time consuming distraction from the proper objectives involved in the administration of a company.

Class actions

18. As discussed above, the Discussion Paper introduces the concept of expanding the Corporations Act to include a duty to take into account the interests of 'stakeholders'. As the concept of 'stakeholder' is broad and far-reaching, the Committee is concerned that this would act to create a monumental increase in liabilities. This may also have the result of exposing insolvency administrators to class actions, or diminishing available returns for traditional shareholders, being employees or general creditors.

Conclusion

19. It is submitted that the issues raised above must be considered by CAMAC before making provision for any integration of CSR into the Corporations Act.

ERNST & YOUNG

Ernst & Young Building
8 Exhibition Street
Melbourne VIC 3000
Australia

GPO Box 67
Melbourne VIC 3001

Tel 61 3 9288 8000
Fax 61 3 8650 7777

24 February 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Level 16
60 Margaret Street
SYDNEY NSW 2000

Dear John

Submission – Corporate Social Responsibility Discussion Paper

We are pleased to provide our submission to the Corporations and Markets Advisory Committee (CAMAC) in response to their *Corporate Social Responsibility Discussion Paper – November 2005* (the Discussion Paper).

We have structured our response to the Discussion Paper based on the matters raised in each Chapter as a whole rather than addressing each question individually.

We would be happy to provide clarification or additional detail regarding any aspects of our submission. Please contact Liza Maimone Principal Environment and Sustainability Services (03) 8650 7348 or Gail Bergmann (03) 9288 8593 Governance and Corporate Culture service leader if you would like to discuss our response.

Yours Faithfully

Rob Perry
Business Unit Director
Risk & Technology Services
Ernst & Young

Chapter 1 – The issue of corporate social responsibility

We favour the definition of Corporate Social Responsibility (CSR) as provided by SustainAbility and addressed in the Discussion Paper (Page 2, Footnote 2):

> ' a business approach embodying open and transparent business practices, ethical behaviour, respect for stakeholders and a commitment to add economic, social and environmental value'.

In particular we believe that any definition adopted should ***avoid*** implying that interests of shareholders and stakeholders are mutually exclusive.

In calling for comment on the most appropriate approach or combination of approaches to responsible corporate behaviour is most appropriate, we would point out that we do not believe the approaches are strictly mutually exclusive.

In terms of legislating a particular approach or combination of approaches we would suggest that the only approach capable of being legislated is the commercial approach, for example mandating company reporting of non financial risks. However, as detailed in our response to Chapter Five of the Discussion Paper, we do not support mandatory reporting and favour a system of supported voluntary disclosure as discussed below.

In addressing the question of the extent to which corporate decision making is already driven by stakeholder concerns we can provide only anecdotal evidence based on our observations. It is our contention that decision makers in corporate Australia are cognisant of the impact on stakeholders other than shareholders of their corporate decisions. There is an understanding that in order to prosper financially in the longer term various considerations, beyond just those pertaining to current shareholders, must be taken into account.

In relation to the question of how companies engage with stakeholders, we would suggest that there is significant variation in the sophistication of stakeholder engagement. However, we note the development of voluntary standards, such as the AA1000 Stakeholder Engagement Standard, whose intention is to improve the quality of stakeholder engagement through defining good practice and a framework against which companies verify their performance. We would suggest that to improve performance in relation to stakeholder engagement there is a need for both greater awareness and understanding of existing standards by both companies and auditors verifying company reports against the standard.

In response to the question of whether there are any changes that could enhance triple bottom line, sustainability or like reporting we would suggest that there are many initiatives already in place which seek to achieve that very outcome. Many of these initiatives have been addressed in the Discussion Paper itself, such as the *Global Reporting Initiative (GRI) Sustainability Reporting Guidelines 2002.* As one purpose of the GRI guidelines is to provide clarity and comparability in sustainability reporting we do not believe it is necessary to introduce requirements that would duplicate this guidance.

Chapter 2 – Directors' duties: current position

The ability or degree to which the current law pertaining to directors duties allows the interests of non stakeholders to be taken into account is beyond our scope of expertise to comment upon. We are unable and do not provide opinion regarding the law or the interpretations made by the courts. It is our general understanding and one which accords with much of the commentary in the Discussion Paper, that directors are not constrained from making decisions that take into account the interests of non stakeholders, if such a decision is 'in the best interests of the corporation'. 'In the best interest of the company' is not limited to an assessment of the impact on current shareholders and can consider for example shareholders in perpetuity.

The extent to which directors themselves feel constrained by the law is one best answered by company directors in the context of individual or company submissions on the Discussion Paper.

Chapter 3 – Directors' duties: matters for consideration

Attempts to ***clarify*** the Corporations Act regarding the extent to which directors may take into account the interests of specific classes of stakeholders may serve only to confuse the issue. We contend that it would be difficult to draft such an amendment. The classes of stakeholders vary for each company and may vary over time. To nominate, specify or rank shareholders would be tedious and would result, we suggest, in a cumbersome and difficult to apply provision. A broad principle based amendment would do little to add clarity.

Similarly we do not support a proposal to amend the Corporations Act to ***require*** directors to take into specific classes of stakeholders. The concerns we raised above regarding clarifying the Corporations Act apply equally or indeed even more so to amendments that would require consideration of specific classes of stakeholders.

We suggest that other mechanisms be explored to raise the issue and address concerns regarding the ability / desirability of directors taking stakeholders into account when making decisions. For example the Australian Institute of Company Directors (AICD) would be one avenue of raising and debating this important issue and could be a resource for directors seeking guidance on the execution of their duties in this regard.

Finally, we believe the emphasis of discussion should be on the balance or consideration given to short term versus long term interests of shareholders and stakeholders rather than an emphasis on specific classes of stakeholders.

Chapter 4 – Corporate reporting

Currently the Corporations Act requires all disclosing entities, public companies, large proprietary companies and registered schemes whose operations are subject to particular and significant environmental regulation under Commonwealth or State / Territory laws to provide details of the entity's performance in relation to the environmental regulation in the annual directors' report.

The directors' report of a listed company must include an 'operating and financial review' (OFR). It must provide information on the operations, financial position and business strategies and future prospects of the company. The explanatory memorandum which accompanied the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act – which introduced the OFR – refers preparers of the directors' report to the Group of 100 guidance on such reporting.

There is also a requirement under the Australian Stock Exchange (ASX) listing rules (rule 4.10.17) for companies to include a review of operations and activities in their annual report. Guidance to the listing rule also supports the Group of 100 guidance as 'best practice' guidelines.

The Group of 100 'Guide to review of Operations and Financial Condition' suggests that various factors should be considered in preparing the review and should inter alia 'deal with the broader dimensions of the company's performance such as sustainability reporting, where that is relevant to users'.

Chapter 5 – Encouraging responsible business practices

Ernst & Young's direct involvement in validating Corporate Responsibility Index (CRI) submissions means we have seen first hand the improvements made by companies participating in this initiative. Companies utilising the framework are seeing definite improvements in management over the short term, with likely long term performance improvements to follow.

The CRI is a voluntary self assessment tool with an independent validation process. The CRI is a management, measurement and reporting tool which provides companies with a practical framework for improving and communicating corporate responsibility performance.

We would advocate government support for establishing a robust *voluntary* reporting mechanism as the most appropriate route to shifting focus to long term responsible management. As such one possibility would be to build on the existing CRI tool to promote wider uptake. We believe that mandatory approaches have an associated risk of creating a culture of 'compliance for compliance sake' or a 'tick the box' climate. A voluntary approach that encourages a culture of sure judgement, responsibility and accountability and challenges the underlying ethical culture is a more desirable result. In addition, the benefit of voluntary approaches is that they allow for the demonstration of leadership and differentiation in the market.

There are a range of current barriers to the uptake of CRI that could be overcome through interim government support. We would encourage government support of the CRI to promote wider uptake to the point of building a critical mass.

The Institute of
Chartered Accountants
in Australia

24th February 2006

Mr John Kluver
Executive Director
CAMAC
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver,

CORPORATIONS AND MARKETS ADVISORY COMMITTEE (CAMAC)
CORPORATE SOCIAL RESPONSIBILITY
DISCUSSION PAPER

This submission is made on behalf of the Institute of Chartered Accountants in Australia (the Institute).

The Institute of Chartered Accountants in Australia is the premier professional accounting body in Australia. Our reach extends to over 53,000 of today's and tomorrow's business leaders, representing more than 43,000 Chartered Accountants and some 10,000 of Australia's best accounting graduates, who are currently enrolled in our world-class post-graduate program.

Our members work in diverse roles across commerce and industry, academia, government and public practice throughout Australia and in 107 countries around the world. We also continue to progress and deliver significant thought leadership projects to the profession, which include the important issue of Corporate Social Responsibility. Therefore, we believe the Institute is well placed to provide comment to the CAMAC discussion paper.

Our response to the questions raised by CAMAC in their discussion paper:

The Institute believes that business enterprises are becoming increasingly aware of the way in which the impact of their operations and behaviour can affect the value of the enterprise and that this is reflected in the extent to which many listed companies are now providing additional non-financial information in their communications with shareholders and other stakeholders.

27–29 Napier Close
Deakin ACT 2600
Tel: 1300 137 322
Fax: 02 6282 9800

TCCI, 30 Burnett Street
North Hobart TAS 7000
Tel: 1800 014 555
Fax: 03 9670 3143

L1/200 Mary Street
Brisbane QLD 4000
Tel: 07 3233 6500
Fax: 07 3221 0856

L3/600 Bourke Street
Melbourne VIC 3000
Tel: 03 9641 7400
Fax: 03 9670 3143

L11/1 King William Street
Adelaide SA 5000
Tel: 08 8113 5500
Fax: 08 8231 1982

Grd/28 The Esplanade
Perth WA 6000
Tel: 08 9420 0400
Fax: 08 9321 5141

The Institute of Chartered Accountants in Australia
ABN 50 084 642 571
Incorporated in Australia Members' Liability Limited
Level 14, 37 York Street Sydney NSW 2000
GPO Box 3921 Sydney NSW 2001
Tel: 1300 137 322 / 61 2 9290 1344
Fax: 61 2 9262 1512
www.icaa.org.au

However, before considering matters such as changes that could enhance triple bottom line, sustainability, or like reporting, or indeed whether any changes are needed to current statutory requirements, the Institute considers it is important to ensure that stakeholders are appropriately informed about what is meant by Corporate Social Responsibility reporting and the various frameworks which currently exist for reporting non-financial information (which includes corporate social responsibility data.)

To this end, the Institute of Chartered Accountants has recently commissioned and published a stocktake of the various reporting frameworks. A copy of this stocktake report is attached and is also available on the Institute's web site:
http://www.icaa.org.au/tech/index.cfm?menu=303&id=A117078814

The Institute believes that it is important to raise the level of awareness and stimulate further discussion about the provision of non-financial data generally before proceeding to specify exactly what information should be included .

Given this, the Institute considers that it is far too early and inappropriate to mandate any further requirements at this time.

To assist in stimulating more discussion the Institute has commissioned a follow up report that will review the outcome of studies, which have been conducted to try and identify the degree of correlation, which exists between the provision of non-financial data and share price.

This information should assist in responding to further questions raised in the CAMAC Discussion paper, such as, the extent to which stakeholders consider a company's social responsibility performance when making assessments, or decisions, about a company.

Yours sincerely,

Bill Palmer

Bill Palmer
General Manager
Standards & Public Affairs Division

GPO Box 2533
PERTH WA 6001

ALBERT WOLFF CHAMBERS
7TH FLOOR
33 BARRACK STREET
PERTH, WESTERN AUSTRALIA 6000

Telephone: (08) 9218 9200
Facsimile: (08) 9218 9300
Mobile: 0408 924 113
Email: mac@wolffchambers.com.au

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Level 16, 60 Margaret Street
SYDNEY NSW 2000

24 February 2006

Dear Sir

SUBMISSION REGARDING PROPOSAL FOR CHANGE: INQUIRY INTO DIRECTORS' DUTIES AND CORPORATE SOCIAL RESPONSIBILITY

It is my respectful submission that the Committee have regard to a proposal for change contained in a submission made to the Parliamentary Joint Committee (PJC) on Corporations and Financial Services for its Inquiry into Corporate Responsibility. That submission was made by the Law Student Community Support (LSCS) organisation, composed of law students from the University of Western Australia, of which I was President when the submission was made. That submission can be found on the PJC’s website.[1]

It is only a proposal for change. But it should, at least, be considered as a means of effecting corporate social responsibility. It is a system which would be imposed upon corporations when making decisions. It imposes an obligation to consider a statutory defined list of factors (social and environmental, among others) and to document that due consideration has been given in the companies boards’ minutes. Depending on the company (its size, industry, location, etc), different factors could be considered. The decisions to which this method of reporting would be applicable would be any of those that affect the company’s operations in a significant way. The details of the system could be particularised and perfected by a Corporate Law Economic Reform Program inquiry.

As minutes have to be lodged with the Australian Securities and Investments Commission, records would show that important points of corporate social responsibility have been respected for that particular board decision. This still permits complete autonomy for corporate decision making. It does, however,

[1] See *Law Student Community Support*, Submission 64, Inquiry into Corporate Responsibility (APH website, URL: http://www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/submissions/sub64.pdf (As at Tuesday 20 December 2005)).

document the corporate intention to disregard a social responsibility of the corporation or its directors. Irresponsibility being documented can have two important consequences. First, negative publicity for those concerned and, secondly, a documentation of the bad corporate intention which may be used as evidential material in prosecutions under completely separate offence provisions to the *Corporations Act 2001* (Cth) (like corporate environmental offences, corporate workplace safety offences and the like).

It would seem that it is a proposal unlike the others suggested. It is also unlike anything adopted in any other nation's system of corporate regulation. It does not portray policy makers' disregard for the issue of corporate social responsibility, because it is 'too hard' or 'too troublesome for the economy', by simply leaving it to financial-data-like indexes. It is also not a practically flawed and impossible suggestion like attempting to amend the directors' duties in the *Corporations Act 2001* (Cth) to cater for corporate social responsibility. Instead, it strikes a balance between legitimate concern for corporate social responsibility and avoiding immense burden on the corporate world that could lead to the negative financial and economic consequences that many currently fear.

Of course, the proposal would have to be more fully considered. I respectfully provide this submission for the Committee's consideration.

Sincerely,

Anthony Papamatheos
Articled Clerk to Mr Thomas Percy QC, Albert Wolff Chambers, Perth

[*The views expressed in this submission are those of the author and not of his Principal or his Principal's Chambers.*]

Credit Union Industry Association (CUIA) submission

CAMAC discussion paper:

Corporate Social Responsibility (CSR)

24 February 2006

Credit Union
Industry Association

Table of contents:

1. Recommendations ____ 3
2. About Credit Unions ____ 4
3. Observations ____ 4
4. Credit Unions' Record on CSR ____ 9
5. Conclusion ____ 16

More information:

Josh Moyes
Adviser – Policy & Public Affairs
Credit Union Industry Association (CUIA)
(02) 8299 9033
jmoyes@cuscal.com.au

1. Recommendations

CUIA proposes the following recommendations:

- CAMAC should allow the regulated-community the freedom to continue to develop their own corporate social responsibility (CSR) initiatives and undertake voluntary disclosure in relation to those initiatives to their shareholders and other stakeholders.

- CAMAC should avoid mandating CSR activities or reporting, as this will impose further costs and burdens on credit unions and other entities that have already experienced significant regulatory compliance costs without effectively promoting the interest of non-shareholder stakeholders.

- If CAMAC does recommend applying hard regulatory rules on CSR, they should ensure that the existing experience and good practice of community-based mutuals like credit unions is appropriately considered such that they are not subject to these measures.

- A role remains for Government and the corporate sector, as well as others in the community, to continue to promote and encourage CSR initiatives.

- It is a function of Government to reduce regulatory burdens, as this occurs credit unions and other entities can redirect compliance resources towards more effective CSR activities.

- The focus of any recommendations should be on the adequacy and effectiveness of CSR initiatives by all organisations, and not merely those of the corporate sector.

- Government should also support the industry-based development of effective measurement of CSR activities.

2. About Credit Unions

For nearly 60 years credit unions have been delivering on a promise to be member focused, to offer fairer fees and to be part of their communities.

There are currently 155 credit unions across Australia. Collectively these credit unions are the 7th largest deposit-taking force in the market servicing over 3.6 million members. Credit unions range in size from $3 million in on balance sheet assets to over $5 billion – together the credit union sector is worth over $32 billion in assets.

Credit unions are pioneers in innovation, such as opening the first ATM in Australia and delivering their services via online and mobile channels. By using these technologies as well as delivering on novel CSR initiatives, credit unions offer a different kind of banking to their communities.

CAMAC will be aware that credit unions are Australian Financial Services (AFS) licensees regulated by ASIC under the *Corporations Act 2001* and subject to its broad array of disclosure and consumer protection requirements as well as mandatory subscription to alternative dispute resolution (ADR) schemes.

Credit unions are also:

- supervised by APRA as Authorised Deposit-taking Institutions (ADI) under the *Banking Act 1959* and subject to risk and capital adequacy obligations;
- regulated by AUSTRAC as cash dealers under the *Financial Transactions Reports Act 1988* and will be reporting entities under the expended Anti-Money Laundering and Counter Terrorism Financing (AML/CTF) legislation;
- subject to the *Uniform Consumer Credit Code* (UCCC), which requires they be sensible to the needs of borrowers; and
- subscribers to a range of self-regulatory codes, including the *Credit Union Code of Practice* and the *Electronic Funds Transfer (EFT) Code of Conduct.* These codes set out the proper treatment for dealing with members, consumers and stakeholders.

Beyond these sector-specific regulations, credit unions are also covered by relevant trade practices, privacy, tax, industrial relations and general business regulation.

Credit unions have experienced considerable consolidation over the past decade. Despite growing total assets and member numbers, the number of credit unions operating in Australia has fallen dramatically from around 400 in 1990. Whilst some of this consolidation is a result of an evolving industry, at least part of the consolidation can be attributed to the significant compliance requirements placed on credit unions.

The impact of these compliance costs on smaller institutions like credit unions has been marked. Further, the related impact on competition and choice within the financial services market – together with the community cost of losing credit unions that often service rural and regional areas – is seldom considered in the policy process.

3. Observations

Credit unions have a long-standing involvement in corporate social responsibility (CSR) and there is likely significant under-reporting of these initiatives among the sector. In this context, CUIA believes it would be premature to undertake legislative reform without first establishing a clear deficiency among the regulated-community in terms of their contribution to and reporting of CSR activities.

CUIA believes before CAMAC recommends any measures to reform the *Corporations Act 2001* to mandate CSR activities or reporting, an assessment should first be made about current practice and how to respond, from a policy perspective, to any identifiable shortcomings.

Additionally, CUIA made a formal submission to the *Parliamentary Joint Committee into Corporations and Financial Services* review of *corporate responsibility* in 2005 – CAMAC was provided with a copy at that time. The PJC inquiry considered directors' duties under the *Corporations Act 2001* and substantially overlaps with CAMAC's *Terms of Reference*.

Both the PJC and CAMAC reviews consider whether directors should be required to include the views of non-shareholder stakeholders when making their corporate decisions. CUIA urges consistency and consultation between CAMAC and the PJC as these important issues are deliberated.

3.1 Definitions & Scope

The terms CSR, corporate responsibility and sustainability, among others, are often used interchangeably, but there is no common agreement on what each terms means. Accordingly, the information that each corporation considers relevant in terms of CSR, to pick one term, will also vary, particularly between corporations of different sizes and industry base. Therefore, CUIA believes caution should be exercised as to the definition of CSR. A narrow definition could make identifying CSR unusually difficult with a limited range of activities being contemplated. More appropriate would be a wider definition, which considers instances of corporate activity broadly in terms of environmental, social, cultural and economic factors.

Further, credit unions believe there is a positive correlation between ethical business behaviour, embodied in CSR activities, with corporate performance. Credit unions are established on a belief that their primary purpose is to serve their members and through them the wider community. To this end, credit unions continually strive to improve their products and services for their members' advantage and through them the wider community as well as to develop initiatives that reflect their corporate values.

As mutual organisations, where each member has an equal vote, credit unions operate under a common set of values. These values include:

- co-operation
- moral integrity
- trust
- financial prudence
- caring for members
- social responsibility

For credit unions, each of these core values is reflective of their CSR in terms of their impact on the way credit unions relate to their members and the community. For example, many credit unions offer fee-free and unlimited Internet banking, BPAY, direct debit, deposits and account transfer services. Others offer unsecured personal loans without application fees or loans that do not penalise members for an early payout.

As mutual organisations, credit unions are not driven solely by profit motives like most other corporations. Instead, they are dedicated to returning benefits to members. This typically arises in terms of fairer fees and product and service pricing as well as their contribution to their local community. Credit unions' mutual structure, together with their core values, means they offer a different kind of banking where they focus on initiatives to deliver benefits to members and the community. Credit unions' members, who Cannex believe receive an estimated $110 per year in extra member value, appreciate and seek out this difference.

In this context, CUIA urges CAMAC to consider a broad definition of CSR that reflects the extensive approach and experience of the credit union sector.

3.2 Sufficiency of Legal Framework

In the current environment, where industry drives the development and assessment of CSR, credit unions have been able to innovate and offer CSR initiatives to their members and the broader community. This has been critical to credit unions' long-standing success as a significant participant in the Australian deposit-taking market. This freedom to develop appropriate CSR initiatives is key to the meaningful relationship credit unions have with their 3.6 million members around Australia. CUIA urges CAMAC to ensure that any reform proposals do not adversely affect reliable and well-regulated credit unions, which already contribute significantly to their local communities.

Imposing special CSR measures on corporate entities presupposes a deficiency, which credit unions strongly refute. Without evidence to suggest credit unions (or other corporations) are failing in their commitment to CSR, any attempt to amend the *Corporations Act 2001* could result in additional costs to credit unions and, unintentionally, retard the promotion and development of CSR initiatives within the sector. This would be a poor outcome without delivering any material benefit for credit union members, consumers or the broader community who are all beneficiaries of the economic and social initiatives and commitment credit unions already make.

Further, the extensive regulatory framework covering the financial sector already adds a substantial compliance and operational cost to credit unions' business, which affects their ability to engage in CSR activities. CUIA believes mandating CSR measures within the *Corporations Act 2001* will add further compliance burdens and costs and adversely affect credit union's ability to develop, apply and harness their CSR initiatives. That is, if mutuals were subject to mandatory CSR obligations the cost of compliance in terms of money, time and opportunity would have to be taken from the hands of members in terms of fees and charges or alternatively from community funding initiatives. This would be an unwelcome outcome for credit unions, most of which were founded upon and remain devoted to their local communities. It would also be inconsistent with the policy objectives being considered by CAMAC.

The interests of shareholders and other relevant stakeholders cannot be disregarded but reform measures should not be drafted inconsistently with director's existing statutory and general law duties to their companies. Moreover, the current regime does not prevent directors from considering the interests of non-shareholders and the broader community. For credit unions, as community-based organisations, those interests are clearly a critical and ever-present consideration.

Company directors have a primary responsibility to their corporations and through that duty to their shareholders. This is a longstanding obligation derived from the general law, director's fiduciary duties and the operation of the *Corporations Act 2001*. Good directors will be conscious of the long-term benefits of CSR for their shareholders and the community. Taking the interests of the company first, directors acting properly will think to the long-term, which can and often does include the company's reputation, its relationship with customers and its interaction with the community and the environment. For credit unions these matters are embedded in their organisational structure and commercial approach and this is emerging within other parts of the corporate sector as well.

If the *Corporations Act 2001* were amended to require directors to make decisions cognisant of short-term and immediate social or other community needs this could retard their strategic and risk decision-making, which would be detrimental to both shareholders and the broader community. It would also divert limited resources from sensible CSR initiatives towards compliance and reporting obligations and consequently constrain CSR innovation. On this basis, CUIA strongly opposes any provision in the *Corporations Act 2001* that require a credit union or its directors to have particular regard to the interests of other parties before the interests of their members (who are their shareholders). This is not a rejection of CSR, which is inherent to the credit union sector, but a reflection of the appropriate allocation of corporate duties, responsibilities and liabilities and the efficient use of limited resources.

CAMAC should note that credit unions' commitment to CSR is tied into their obligations to their shareholders. Even without a mandatory obligation within the *Corporations Act 2001*, credit unions continue to seek out and develop CSR initiatives as a matter of good business practice. Accordingly, under the current regulatory framework, CUIA does not believe the case has been made to support the assertion that the law inhibits corporations from making socially responsible decisions or decisions that account for non-shareholder stakeholders.

3.3 Promotion of CSR: A Role for Government & Industry

CUIA believes the lessening of regulatory costs, which is a function of Government and the subject of current Commonwealth[1] and State-based red-tape reviews, would be key to facilitating further CSR by credit unions and other entities. Therefore, CUIA urges CAMAC to adopt a wait and see approach. This will allow the corporate sector to continue its current trend of developing responsible practices and initiatives, a trend that is already part of credit unions' philosophy and corporate approach. This approach will also allow compliance reforms from the red-tape reviews to lead to regulatory savings and efficiencies, which will flow through to greater resourcing of CSR initiatives. Additionally, a wait and see approach will allow the various measurement tools (discussed at 3.4 below) to be finished and implemented. With the benefit of these measuring and assessing tools, industry and Government will be more readily able to identify, report and assess the quality of their CSR activities.

Supporting this approach, Federal Industry Minister, Ian MacFarlane, commented in 2005 that the environmental conscience of shareholders should lead companies to adopt CSR practices. The Minister said *"the triple bottom line that shareholders expect these days should be more than enough incentive for companies to do what is basically the right thing."*[2] Other commentators have observed the role of Government is not to force corporations to be socially responsible but to facilitate and reward such behaviour[3]. Similarly, the Minister for Foreign Affairs, Alexander Downer, said in January 2006 that *"the corporate world increasingly realises it has to be responsible."*[4]

The motivation for CSR, in CUIA's view, should be one of long-term business benefits rather than compliance with an arbitrary regime imposed by Government or regulators. CUIA believes there are many leading businesses – including many credit unions – that have embraced CSR because it makes sense and through their awareness of the strategic opportunities it can provide. A voluntary, industry and stakeholder driven approach to CSR is therefore preferable.

This view is also aligned to the Government's comments in response to the proposed *Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights*, developed by the *Sub-Commission on the Promotion and Protection of Human Rights* within the *UN Commission on Human Rights*. Writing in the context of international legal responsibility for human rights standards, the Government commented:

[1] Consider the Prime Minister's and Treasurer's *Taskforce on Reducing the Regulatory Burdens on Business*
[2] Breuch J., *'Minister places faith in shareholder conscience'*, Australian Financial Review, 10/01/2006 at 5.
[3] Anderson G., CSR opens new avenues to community', Australian Financial Review, 10/01/2006 at 41
[4] Frew W., Freed J. & Peatling S., *'Trust firms on climate, say leaders'*, Sydney Morning Herald, 12/01/2006

> *"The Australian Government is strongly committed to the principle that guidelines for Corporate Social Responsibility (CSR) should be voluntary … We believe the way to ensure greater business contribution to social progress is not through more norms and prescriptive regulations, but through encouraging awareness of societal values and concerns through voluntary initiatives."*[5]

CUIA believes this international stance should be reflected in Australia's domestic policy position. This does not mean CUIA believes reforms to encourage Boards and their directors to consider CSR should not occur, but that such reforms should be voluntary and avoid unnecessary, prescriptive, costly and counterproductive regulatory measures.

3.4 Practical Implications: Measurement & Coverage

CUIA agrees CSR is not only the right thing to do but it should be measurable as being good for business as well. Unfortunately, measuring CSR is very difficult and current domestic and international attempts indicate this is an evolving process. For example, the Commonwealth Government's *Australian Research Council Linkage Projects* has provided a grant of funds to the *University of Sydney* and *CPA Australia* to develop a framework for managing and reporting non-financial information. Relevantly for this CAMAC review, this 3-year project is exploring sustainability management and reporting by companies and not-for-profit organisations.

Additionally, the *St James Ethics Centre's* released its *Corporate Responsibility Index* (CRI), which offers an alternative to hard and fast regulatory compliance by providing a mechanism for business to assess the responsibility and sustainability of their business practices against recognisable benchmarks. CUIA believes this budding area does not require heavy regulation and urges CAMAC to avoid recommendations that will apply statutory measurement or disclosure obligations, which may stifle these measurement techniques, when the ability to measure or assess compliance remains embryonic.

Despite these challenges, the credit union sector is actively seeking to develop tools of its own to monitor and report on CSR. Significantly, the *Credit Union Foundation of Australia* (CUFA) has developed a *Corporate Social Responsibility (CSR) Toolkit* for credit unions to frame their CSR activities. The *CSR Toolkit*, which will be formally launched in April 2006, links into the competitive attributes of community focus, social responsibility and mutual interest and will enable credit unions to learn about CSR, to capture their CSR activities and to generate sustainability reports. The *CSR Toolkit* is aligned to the *Global Reporting Initiative's* (GRI) international reporting framework.

CAMAC should note that mandating CSR under the *Corporations Act 2001* would capture a great many companies across Australia but it would not reflect the wealth of CSR activities being conducted by not-for-profit and other organisations not presently regulated by the *Corporations Act 2001*. Equally, it would not require CSR compliance by partnerships, individuals or other non-corporate forms of organisation or even governments. Accordingly, the focus of any recommendations should be on the adequacy and effectiveness of CSR initiatives and reporting by all organisations, and not merely those of the corporate sector.

This lack of consistency would undermine the effectiveness of a CSR disclosure and reporting regime by creating an imperfect picture incapable of effective comparison or measurement. Additionally, without an ability to objectively assess compliance, enforcing accountability will become a significant extra burden for credit unions and other corporations, posing a competitive disadvantage by imposing extra CSR-based costs without necessarily delivering material benefits to the broader community.

[5] AAR, *'Update on the Australian Government's corporate social responsibility inquiries'*, Focus – Corproate Governance – November 2005, located at http://www.aar.com.au/pubs/ma/focgnov05.htm.

Developing CSR practices or benchmarks for corporations to provide useful reporting against is also difficult due to the general infancy of these activities and the variances between different corporations as to their understanding and application of CSR. CUIA is concerned that applying a disclosure regime to account for CSR could simply produce an extra and costly compliance burden that does not meet the needs or expectations of non-shareholder stakeholders. This would also work as a disincentive to engage in further CSR innovations.

As a final thought on reporting and disclosure, the recent admission by ASIC in relation to the effectiveness of their FSR disclosure regime in terms of consumer understanding and value are timely. ASIC's Deputy Chair, Jeremy Cooper stated:

> *"…most investors simply don't understand the information in disclosure documents;"*[6]

Accordingly, CUIA believes additional disclosure should be encouraged but not prescribed. This will allow corporations to respond to the demands of their shareholders, members and other stakeholders in terms of their CSR activities and reporting.

4. Credit Unions' Record on CSR

The credit union sector is replete with examples of their strong community focus and their particular commitment to CSR. Reinvesting in their communities and engaging in CSR is important to credit unions as they seek to satisfy their social obligations through, *inter alia*, community support, culturally appropriate services, philanthropy, environmental consciousness, microcredit and microfinance and financial literacy measures.

The following are only selected case studies and commentary relating to credit unions' commitment to CSR. These are just an example of the range of CSR initiatives credit unions achieve under the current legislative and reporting framework. It is precisely these types of initiatives that could be at risk if credit unions were required to re-direct their limited CSR resources towards mandatory CSR compliance and reporting.

4.1 Community Support

Many credit unions offer grants to their local community. These may be to assist others to realise their potential, to help people with a particular need or facing an emergency or to make a difference by supporting innovative and creative thinking and activities. There are numerous examples of these types of grants among credit unions; an excellent illustration is the community grants offered by *RegionalOne Credit Union*.

> *RegionalOne Credit Union in Victoria recognises that as a community-owned organisation they have a responsibility to contribute to their region. In this context they offer grants to provide a start to members of the community who have ideas to address a community need. Grants are also made to encourage participation and collaboration to solve a problem or to promote creative or innovative thinking. Since December 2002, RegionalOne has issued over 90 grants. A list of these grants is available at: www.regionalone.com.au*

Another example is *WAW Credit Union*, which supports an annual community fundraising campaign for the local hospital network.

> *WAW Credit Union reversed the word 'hospital' when conceiving 'Latipsoh Day' in 2001. This annual community fundraising campaign is designed to raise funds for the regional hospital network. The network comprises 11 local hospitals spanning from Culcairn to Yackandandah, which provide essential health services for WAW Credit*

[6] Garnaut J., *'ASIC says disclosure rules not working'*, Sydney Morning Herald, 06/02/2006 at 19

> *Union's regional members. The funds raised during the campaign are used to help each hospital to improve their facilities and purchase much needed equipment.*
>
> *WAW Credit Union formed a committee from its administrative staff to help with the paper work involved in co-ordinating Latipsoh activities. Working alongside other major sponsors, WAW Credit Union enlists the help of hospital management and staff and the local community to co-ordinate this critical fundraising event.*
>
> *The member for Farner, Mrs Susan Ley observed that it is essential people recognised the crucial role hospitals play in the community and she believes that "Latipsoh day helps highlight the importance of community support to keep these services viable."* [7]

A further example is *Savings & Loans Credit Union's* support of the annual Christmas Pageant in South Australia as well as their contribution – leveraged off a retail credit card product – to the Women's and Children's Hospital.

> *Savings & Loans Credit Union in South Australia prides itself on giving back to the communities in which it operates and what better way than supporting a family favourite – the Glenelg and Naracoorte Christmas Pageants. These free family fun days uphold what Savings & Loans stands for, it's accessible to everybody, it's supporting the community and most particularly it's for families.*
>
> *Savings & Loans Credit Union with five other credit unions in South Australia also sponsors the Credit Union Christmas Pageant, marking the traditional beginning of Christmas in Adelaide. See http://www.cupageant.com.au for more information.*
>
> *Savings & Loans Credit Union also offer a Women's and Children's Hospital Visa Card. This is a community-minded card. At no cost to the cardholder, a percentage of all Visa purchases go towards the much-needed upgrade of the Hospital's emergency department. Over $1.5 million has already been raised and construction is underway.*
>
> *"The generosity of Savings & Loans Credit Union and its members means we will complete this important project years ahead of what would otherwise have been possible," said Heather Gray, chief executive of the Children, Youth and Women's Health Service.*
>
> *More information about the Women's and Children's Hospital Visa Card is at: http://www.wch.sa.gov.au/support/corporate/savingsloans.html*

These are just a few examples of the type of contribution, replicated across Australia, the credit union sector already makes to individuals in the broader community. These measures are motivated by credit unions' commitment, at both the corporate and local branch level, to their individual communities.

4.2 Culturally Appropriate Services

Traditional Credit Union (TCU) was established in 1994 to provide culturally appropriate financial services to Aboriginal people living in remote communities in the Northern Territory, particularly those disadvantaged by a lack of existing services.

TCU has its head office in Casuarina and branches in Milingimbi, Galiwinku, Gapuwiyak, Ramingining, Maningrida, Wadeye, Gunbalanya, Warruwi, Ngukurr and Numbulwar. TCU seeks to use local staff to operate its branches, creating employment opportunities for Indigenous people to work in and manage its remote branches.

The PJC's *Money Matters in the Bush'* (2004) report recognised the importance of TCU to the Indigenous community, quoting TCU director Mr Djerringal Gaykamanu:

[7] Ley S., *'Nothing backwards about this appeal to the community'*, Wodonga Regional health Service located at http://www.wrhs.org.au/news/2003812474.htm

> *"I started in the sixties to work with the people, bit by bit, for community development and I am still working. I am the eldest at Milingimbi. I look after the community and I look after the TCU. I know the background story of the TCU – where it started, where it has come from and what it is like now. The TCU is a very big name and it has become really good. Everybody is happy that we started small and have grown big. That is very important for our training, for business and for saving money. We can show our kids down there why we started it up."*

First Nations Australia Credit Union (FNACU) was founded in 1999 to assist Aboriginal and Torres Strait Islander peoples take control of their finances and economic futures by establishing an independent Indigenous credit union, owned and operated by Indigenous people, to provide quality services to members.

FNACU provides culturally appropriate financial services to over 3,000 Aboriginal and Torres Strait Islander members across Australia. Wherever possible, FNACU employs and trains Indigenous people as staff, managers and directors – currently 70% of FNACU staff is Indigenous. FNACU developed the *My Moola* booklets on budgeting and saving[8]. Demonstrating the success of this publication, a subsequent series of *My Moola* financial literacy materials were produced by ASIC.

The importance of providing culturally appropriate banking and financial services was recognised by the PJC in *'Money Matters in the Bush'*. In particular, the PJC recognised that the existence of these credit unions meant that geographically isolated communities can still access banking and financial services and that Indigenous consumers can access culturally appropriate financial services and literacy materials.

TCU and FNACU are prime examples of the benefits of community-orientated organisations such as credit unions. The *Northern Territory Government*, the *Department of Family and Community Services* and *Reconciliation Australia* have, among others, has also acknowledged the important role and contribution of TCU and FNACU.

4.3 Providing Services in No-Bank Locations

Credit unions, through Cuscal, and the Commonwealth Government undertook a joint *CreditCare* project from 1995 to 2000. This project aimed to maintain and develop banking and financial services infrastructure in rural and remote areas where these services had been withdrawn or where there had never been any such services. This program did not simply offer funding to enterprises to open services in regional communities, in fact the start up and operations costs remained with individual credit unions. Instead, the *CreditCare* project fostered self-help among communities in need. The PJC recognised the contribution of credit unions where it quoted Dr Gary Lewis in its *Money Matters in the Bush* report:

> *"The model was carefully designed to neither directly fund nor subsidise the establishment of credit union branches or agencies. Rather the program provided resources to assist communities themselves discover the means of re-establishing financial services utilising existing resources, and link these with a host institution. CreditCare's maxim was that it was in a community not simply to help but to help a community help itself."*

In the 5 years of its operation, *CreditCare* visited 170 towns and provided 58 communities with a branch or agency, 50 of which were provided by credit unions.

Building on the success of the *CreditCare* project, the wider *Regional Transaction Centres* (RTC) program was established by the Commonwealth Government with a focus on small towns and communities. Each RTC under the scheme offers basic financial services,

[8] http://www.firstnations.com.au/Tips_Advice/mymoola.asp

telecommunications, *Medicare* facilities, *Centrelink* services and other Government services. Drawing these services together makes the development of a RTC more viable than if any of these services sought to operate on their own.

4.4 Philanthropy

The *Credit Union Foundation Australia* (CUFA) supports the philosophy and principles of the credit union sector. Funded by credit unions and Cuscal, CUFA is a development agency for the Australian credit union sector. CUFA has both a domestic and international presence.

> *A recent example of CUFA's work includes their management of the collection of over $600,000 in funds for the Credit Union Tsunami Appeal, following the Boxing Day 2005 natural disaster.*
>
> *CUFA also assist with the embryonic credit union movement in the Asia-Pacific region through microfinancing activities. Based on the principles of mutuality, CUFA endeavours to be involved with projects that encourage the manifestation of grass roots financial initiatives that offer the local population an ability to be engaged in their country's emerging financial sector.*
>
> *CUFA's current microfinance projects involve:*
>
> *Bougainville:*
> - *there are 237 active Grassroots Microfinance Initiatives (GMFIs), comprising 103 in North Region, 62 Central and 72 South Region*
> - *there is a total membership of GMFIs of 15,073.*
> - *there is a total savings of Kina 2,312,945 (AUD$951,829)*
> - *there have been total loans disbursed of Kina 1,449,635 (AUD$596,558)*
>
> *Indonesia and Philippines:*
> - *35 partner CUs in Manila and West Kalimantan to recruit a total of 12,250 new members by 30 June 2005*
> - *savings of US$245,000 generated from 12,250 new members*
> - *provision of loans totalling US$200,000 to 10,000 new members*
> - *increased number of poor people participating in gender balanced decision making at village level CUs*
> - *25% increase in ordinary savings of the 35 project partner CUs*
> - *build and strengthen the professional management capacity of 20 CUs in Manila and West Kalimantan*
>
> *Cambodia:*
> - *36 active Savings Banks (SBs) have been set up*
> - *total membership of 18,262 which includes 11,600 females*
> - *370 people (170 female) trained and active as Directors, members of Executive, Supervisory and Credit Committees and employees of SBs*
> - *total savings accumulated US$34,978, comprising US$12,241 compulsory savings and US$22,737 voluntary savings*
> - *total loan balances outstanding to 5314 active borrowers - US$615,603*
> - *5000 families affiliated to micro-insurance program*
> - *enhanced legal environment for CU development including Government policy and regulation in place to enhance cooperative development*
> - *community perception changed from an external micro-credit environment to member owned and operated savings.*
>
> *In 2004, CUFA partnered with FutureStaff, a registered training organisation, to develop financial literacy needs in regional Australia. The aim was to equip participants with the skills they need to manage their personal finances. The first pilot was run in partnership between New England Credit Union and the Armidale Aboriginal Medical Service employees. The second pilot involved Orange Credit Union together with the Orange Aboriginal Medical Service, Mid-Western Health Service and key local Indigenous representatives.*

Individual credit unions also engage in their own philanthropic activities. For example, the *City Coast Credit Union Foundation* (CCCUF), which is now part of CUA, was established in 2003 to support initiatives in the communities in which City Coast Credit Union operated.

> *The CCCUF builds on credit unions' heritage and belief that people helping others can achieve great things. The CCCUF provides two grants a year, worth between $3,000 and $15,000, for projects that help the community through economic growth, environmental sustainability and social development. Its first grant of $10,000, for example, is supporting a community-based program that aims to protect and improve the Illawarra's many natural environment areas.*

Another example is *Berrima District Credit Union's BDCU Community Fund* and *Children's Fund*.

> *Berrima District Credit Union established the BDCU Community Fund to encourage philanthropy in Berrima's community. Through consultation with other community groups, the Fund has focuses on youth affairs and giving back to the community.*
>
> *The Fund has raised enough money to:*
> - *pay for a part-time youth worker in the area;*
> - *provide a youth oriented website; and*
> - *establish a local youth radio station.*
>
> *Following the success of the Community Fund, BDCU created their own Children's Foundation to assist in raising money for the redevelopment of the children's ward at the local hospital and to provide ancillary support services for the children on the ward and their families.*
>
> *The board of the Children's Foundation comprises of members of the local community and employees of BDCU creating an active and ongoing relationship between the two.*
>
> *Further, BDCU allows local community groups to use its boardroom facilities free of charge to hold meetings and for social occasions. All of these activities not only help the local community but also provide a way for other members of the community to get involved in philanthropic activities.*

St. Mary's Swan Hill Credit Union's contribution during 2005 of $20,000 to various community groups such as the Red Cross, Swan Hill Bowls Club, Swan Hill Agricultural & Pastoral Society, Swan Hill & District Cricket Association and Swan Hill District Hospital is another example[9].

4.5 Environmental Consciousness

A number of credit unions offer products and services that are environmentally responsible. For example, as a signatory to the *United Nations Environment Programme Statement by Financial Institutions on the Environment and Sustainable Development*, Victorian credit union *mecu* has adopted a *Sustainability Strategy*. Reflecting this strategy are *mecu's* award winning *goGreen* car and home improvement loans.

> *mecu in Victoria offers the Banksia Award winning goGreen Car Loan, which sets out different interest rates depending on the emissions of the vehicle purchased. The lower the emissions the lower the interest rate. Additionally, to help reduce the impact of these cars on the environment, mecu offset 100% of the greenhouse gas emissions that goGreen loan purchased cars produces for the life of the loan.*
>
> *They do this in partnership with Greenfleet by planting and maintaining 17 native trees per goGreen Car Loan in the Murray Darling Basin. As these trees grow, and there are now over 22,000 trees planted under the scheme, they absorb greenhouse gas*

[9] Information obtained from Ken Mutton (General Manager), St. Mary's Swan Hill Credit Union, kmutton@stmarysco.com.au

> *emissions and help tackle salinity, improve water quality and provide essential habitat for endangered species.*
>
> *mecu also offer a goGreen Home Improvement Loan where borrowers can save money through lower interests rates where they seek to save the environment by updating their home with energy and water saving devices. For example, heat pumps (reverse cycle air conditioning), high efficiency gas heaters, solar electricity generation, wind electricity generation, solar hot water, grey water recycling system, waterless composting toilets, rainwater tanks, insulation, 5 star energy efficient glazing and awnings.*

Another example of environmentally aware corporate activity is *Maleny Credit Union's Cool Home Loan*.

> *The Maleny Credit Union (MCU) in Queensland offers a home loan that directly encourages energy efficient housing. The loan offers a discounted competitive interest rate and no ongoing fees for homes that meet five or more energy saving criteria.*
>
> *To qualify for a Cool Home Loan, in addition to satisfying normal credit guidelines, borrowers need to meet criteria comprising features that go to make a home energy efficient. For example:*
> - *water efficient fittings;*
> - *ceiling, roof and walls insulation;*
> - *connection to Earths Choice Electricity;*
> - *windows tinting and external awnings or shadings over windows; and*
> - *solar PV panels.*
>
> *The "Cool Home Loan" has been developed in conjunction with the Queensland Conservation Council as part of the Cool Communities initiative. For more information see: http://www.malenycu.com.au/coolhome_html*

4.6 Microcredit

As part of their commitment to CSR, credit unions have well-established relationships and continue to offer financial services to low-income earners as well as to vulnerable consumers. Historically, many credit unions were established on the basis of people coming together to form co-operatives to provide financial services to consumers otherwise unable to access these services in the mainstream credit market. Without this contribution, many of these consumers would be prey to opportunistic fringe lenders.

The focus on microcredit within the credit union sector generally revolves around the provision of low or no interest loans to assist members in their local community. An excellent example is *Fitzroy & Carlton Community Credit Co-operative*, a community-managed credit union providing financial services to people on low incomes.

> *Fitzroy Carlton Community Credit Co-operative in Victoria has nearly 4,000 members, a large proportion of whom receive pensions or benefits and their loans are for less than $1500. Small loans are offered to members who would not qualify for credit at other financial institutions. These loans allow members to prove their ability to repay even if their debt to income ratio is high. These loans are for household goods, school costs, holiday costs, car repairs, debt consolidation or emergencies like family sickness and death. Emergency loans (up to $400) are offered with no interest charged, for members who find themselves in urgent financial circumstances. These loans are conditional on the establishment of a budget account to bring outstanding debts under control and to avoid future financial hardship.*

A further example is the NSW-based *Encompass Credit Union's Boomerang Grant Scheme*, which was the recipient of a *2005 NSW Fair Trading Award*[10].

[10] http://www.fairtrading.nsw.gov.au/awards/einfeldawards.html

Encompass Credit Union in New South Wales, together with Barnardos Australia, have developed a microcredit scheme for residents of a housing estate, in the Penrith region of outer Sydney. Encompass Credit Union have put up $10,000 a year over 3 years and residents can apply to Barnardos for an interest free loan to purchase essential items. When the money is repaid to Barnardos, it is re-lent to other applicants from the same housing estate. There have been no defaults under the scheme, a strong indicator that this initiative is contributing meaningfully to breaking the cycle of poverty facing residents who have low-incomes or are welfare recipients.

These types of commitments to the community should be carefully considered before legislative reforms are introduced that could, perhaps inadvertently, retard the development of these worthy initiatives. It would be a perverse outcome, and counter to their history, philosophy and market position, if credit unions were forced to abandon some of their CSR activities as a result of undue compliance and cost burdens associated with identifying and reporting CSR initiatives.

4.7 Financial Literacy

As part of their effort to promote effective decision-making among members and to counter the risks of over-commitment, high household debt and other financial hazards, credit unions undertake a range of financial literacy initiatives. CUIA was awarded the *Consumer Service Award (Business/Industry Association category)* at the NSW Office of Fair Trading's *4th Annual Consumer Protection Awards* in 2004 for its *Take Control* and *The Good Dosh* financial literacy publication series. This Award recognised the credit union sectors' long history and commitment to developing useful and effective financial literacy initiatives for members and the broader community.

Other examples of credit unions role in financial literacy include:

Berrima District Credit Union in New South Wales developed workshops on money skills for year 6 primary school students and year 12 high school students in the Southern Highlands and Tablelands.

Community First Credit Union in New South Wales has developed their FirstEducation scheme, which produces educational materials for members, but is not a sales tool.

Horizon Credit Union in New South Wales has provided seminars with Bridges on pre-retirement strategies, financial planning and investments.

Police and Nurses Credit Society in Western Australia has a range of initiatives designed to assist members gain financial freedom, these include:

- *Member Advice Officers visit members in their workplaces to provide seminars about financial products, fee free banking and how to access their accounts in different ways;*
- *talks to the Retired Police Association about pre-retirement and retirement issues associated with money management and planning;*
- *the Financial Planning arm of Police and Nurses Credit Union hosts seminars to inform members about superannuation; and*
- *a planned initiative to provide money management advice to local high school students in the Perth metropolitan area.*

Queenslanders Credit Union in Queensland run Personal Better Budgeting sessions to equip families and individuals with skills to establish and successfully run budgets – this is not a sales activity. Budgeting sessions are also offered in collaboration with Brisbane City Council.

Queensland Teachers Credit Union in Queensland has implemented a financial coaching program for secondary school students to teach basic money management skills encourages students to develop healthy financial habits.

> *Traditional Credit Union in the Northern Territory has a significant range of positive, effective and culturally appropriate financial literacy initiatives. Many of these were highlighted and recognised in the Parliamentary Joint Committee on Corporations and Financial Services' report 'Money matters in the bush'.*
>
> *WAW Credit Union in Victoria produced a children's book entitled 'Buck's Big Adventure', which is designed to educate children about the importance of money and how it works in the local community.*

Credit unions' contribution to financial literacy was also recognised in the *Australian Consumers and Money* report of the *Consumer and Financial Literacy Taskforce* in late 2004 (now the *Financial Literacy Foundation*). CAMAC should consider credit unions' broad range of financial literacy initiatives, as well as the content of this national financial literacy report and the ongoing objectives of the *Financial Literacy Foundation*, before framing any recommendations that mandate tis type of CSR activity within the bailiwick of the *Corporations Act 2001*.

5. Conclusion

For much of corporate Australia, CSR remains in its infancy in terms of what it means and what should be left to corporations to voluntarily disclose and what may need to be mandatory. But for credit unions, CSR has been part of everyday business for nearly 60 years.

CUIA believes the uncertainties in terms of CSR itself, measuring and assessing signal the need for further investigation on the specific benefits to shareholders, markets and other stakeholders of an active CSR activity and reporting regime when weighed against the compliance costs and potential dilution of available funds. This review by CAMAC, following the earlier discussion by the PJC, is a step in the right direction in terms of exploring what CSR means and how it can best be promoted and communicated.

As mutuals, credit union directors' responsibility to their shareholders is not driven purely by a profit motive like other corporations, but is based on delivering fairer fees to members and engaging with their local community. CUIA believes, consistent with current law, it is up to shareholders to provide the impetus for CSR.

Credit unions are already heavily engaged in CSR activities because their members demand it. That is why members join their local credit union, that is why credit unions consistently receive high satisfaction rates with their member surveys[11] and that is why credit unions are an integral part of their local communities.

Therefore, CUIA rejects the need for legislative reform applicable to credit unions to mandate CSR as either an element of the directors' obligations or in terms of any other reporting or disclosure obligations under the *Corporations Act 2001*. If such reform is required due to an identifiable deficiency among non-mutual corporate entities then those amendments should target these elements of the regulated-community alone.

[11] Eureka Strategic Research (2003)

st james ethics centre

24 February 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Re: Inquiry into Corporate Social Responsibility

This letter constitutes our submission to the Corporations and Markets Advisory Committee (CAMAC) regarding its current inquiry into corporate social responsibility (the current enquiry). By way of additional context, we would like to draw CAMAC's attention to our earlier submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in September 2005. Our submission to the PJC complements the views expressed below and is attached. We provide here a brief excerpt from that earlier submission in order to highlight the core of our position as reflected in this document:

> We believe that the use of legislation, regulation and surveillance as the principal means for protecting the interests of stakeholders other than shareholders is misguided. Our concerns are twofold. First, an over-reliance on such an approach is largely ineffective because it invites a negative culture of compliance characterised by indifference to the principles that inform the legislation or regulations. In these circumstances, corporations become adept at playing a game of 'regulatory arbitrage' – across jurisdictions and through the exploitation of loopholes.
>
> Second, we believe that an over-reliance on regulation and surveillance can inadvertently weaken the ethical sinews of society. When people comply by merely 'ticking the box', then they are absolved (or absolve themselves) of any responsibility for choosing to act in a manner that is right and good. One of the unintended consequences of a system designed to ensure that people cannot choose to do what is wrong is that they can no longer choose to do what is right. They no longer choose at all – they merely comply. This weakening of the ethical sinews of society generates considerable, latent risk. If for any reason the regulations fail, the lack of underlying resilience can lead to a broad failure of responsible conduct.

We should be clear on one point; the corollary of our argument against an over-reliance on regulation and surveillance is that business voluntarily seek to maintain and improve its conduct and that its performance be measured and reported on using a credible, independent instrument to do so.

The particular focus of this submission is in answering the third question posed in the Terms of Reference for CAMAC's current enquiry. In addressing this question we have taken into consideration the three sub-questions posed by the Committee.

Question 3: Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

- To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?
- What lessons might be derived from any experience with voluntary initiatives?
- What would be the nature of any proposed initiative, what would be its intended purpose and consequences, how might it be implemented and what would be its costs and other implications?

Yes, Australian companies should be encouraged to adopt socially and environmentally responsible business practices.

It is widely acknowledged that public confidence and trust in business is low. Some might be tempted to address this phenomenon by using legislation, regulation and surveillance to create a 'virtuous marketplace'. While a responsible and prudent government will ensure a sound legislative environment supported by appropriately resourced regulators, it will not rely on this set of instruments alone. Beyond the Centre's reasons for holding this view (as outlined above) the Business Council of Australia has argued that the current extent of business regulation and surveillance imposes unsustainable costs on the economy of Australia. Consequently, there is a strong case for reducing the incidence of regulation and surveillance – on the condition that such reductions lead to an increase in corporate responsibility. Ideally the increase in performance in this area should be the result of voluntary commitments made by Australian business.

In the current environment, there is growing interest in the value of measuring the incidence of corporate responsibility and on reporting performance as one of the ways directors discharge their responsibility to act in the best interests of the company as a whole. However, many companies need encouragement and support in this area. Part of this is provided by leading companies who have blazed a trail for others to follow. However, where the spirit may be willing, the infrastructure needed for an effective voluntary response by business is relatively weak. Thus the conditions are ripe for the Government to facilitate the expansion of a voluntary initiative of the kind outlined below.

We believe that the voluntary use of a common, principles-based tool for performance measurement and enhancement is the most effective way to achieve high levels of corporate responsibility without excessive recourse to regulation. A tool designed to assist companies to manage and report on their non-financial risks and impacts would strengthen the overall management capacity of Australian businesses and help to build public confidence in the institution of business.

Proposed Initiative: The Corporate Responsibility Index

Desired State
To achieve a shift in business focus to long-term performance with the principles and practices of corporate responsibility widely adopted as the accepted standard of good business practice (across the board).

Intended Purpose of the Initiative
To assist Australian business to be more sustainable (high trust=lower costs) through the establishment of a voluntary, credible and independent tool by which Australian business can measure and improve its performance across the leading indicators of corporate responsibility.

The Tool

St James Ethics Centre is trustee of the Corporate Responsibility Index (CRI) in Australia. The CRI is currently the only voluntary self-assessment tool for measuring corporate responsibility in Australia. Critical to its credibility is the existence of a robust, professional and independent validation process. The CRI is an existing tool with global credentials with strong support from participants, partners and members of the CRI advisory groups[1].

Designed by business for business, the principal purpose of the CRI is to help companies drive improved performance. The public reporting of high level results, for company performance, provides additional information for investors (who increasingly see the relevance of such data when making mid to long-term investment decisions) and helps to build public confidence in the ability of business to self-regulate.

As was noted in the Corporate Social Responsibility Discussion Paper released by CAMAC in 2005 (section 5.3.3 Market indices p.107) the CRI is comprised of four key components on which companies must report. These include:

1. **Corporate Strategy**: examines how a business' activities influence its company values, how these tie into strategy and how they are addressed through risk management, development of policies and responsibilities held at a senior level in the company.
2. **Integration**: examines how companies organise, manage and integrate corporate responsibility throughout their operations. Is it part and parcel of the company culture? Is it integrated into the strategic decision-making processes of the company and linked through into internal governance and risk management systems?
3. **Management**: successful integration is assessed through the Management section where the processes for managing different stakeholder relationships are reviewed. It examines the policies, objectives and targets set to manage key issues in the Community, Environment, Marketplace and Workplace arenas and how these are communicated, implemented and monitored.
4. **Performance and Impact**: examines how a company is actually performing in practice across a range of social and environmental impact areas and whether targets for performance and management improvement are being set and met across these impact areas.

CRI background

- Research conducted by Business in the Community[2] (BITC) in 2000 identified a need for reliable, standardised information that would enable a company's performance to be compared with that of its peers. On the back of these research findings and the seven year success of the Business in the Environment Index, BITC designed the CRI framework in conjunction with over 80 UK businesses.

- St James Ethics Centre identified a similar need for an Australian voluntary, business-led Index. Using sound methodology this Index was to engage with companies from all sectors and focus on corporate responsibility.

[1] The CRI external stakeholder advisory group involves representatives from industry (for example, Financial Services Institute of Australia, ICAA, AICD), NGO groups (for example, Greenpeace, ACF, Amnesty, EPA Victoria) and sustainability practitioners. An advisory group from business has also been established with representatives from current participating organisations (BHP Billiton, Rio Tinto, Toyota Australia, Westpac Banking Corporation).

[2] Business in the Community is a unique movement of 700 member companies in the UK committed to improving their positive impact on society. Please refer to www.bitc.org.uk for further information.

- BITC donated the CRI under licence to St James Ethics Centre for use in Australia. St James Ethics Centre is trustee of the CRI in Australia, overseeing the quality and integrity of the project. The CRI has been implemented as a partnership between St James Ethics Centre, media partners *The Sydney Morning Herald* and *The Age*, and Ernst & Young who validate company submissions[3] to the CRI on a *pro bono* basis.
- The CRI was launched in Australia[4] in late 2003 and is now in 2006 in its third cycle. To date, 32 Australian businesses have participated[5], including 14 from the ASX50. Sectors represented include: consumer discretionary, consumer staples, energy, financials, healthcare, industrials, information technology, materials, professional services, telecommunication services and utilities. We have also had one New Zealand participant to date.
- The CRI is now in its fifth year in the UK with over 130 participants drawn from FTSE 100, FTSE 250, DJSI sector leaders and selected members of BITC.

Advantages of the CRI model

- **A Management, Measurement and Reporting Tool Allowing Benchmarking**: the CRI is a management tool that helps organisations to improve their actual performance and to benchmark within and across sectors.
- **Improved Business Performance**: research demonstrates a link between corporate responsibility and improved business performance. The results of the AMP Capital Investors 'Financial Payback from Environmental and Social Factors' survey states that companies with a higher corporate social responsibility rating[6] have outperformed the ASX200 Index by more than 3.0% per annum over 4-10 year periods[7].
- **Improved Stakeholder and Public Confidence**: a voluntary approach by business, supported by sound external verification of claims, and reported publicly, assists to improve public confidence and trust in business.
- **Reduces the need for Regulation**: the CRI encourages a principles-based approach, reducing the risk of a compliance-based culture. It assists companies voluntarily to improve corporate behaviour by providing a framework for building internal capacity. Increased public confidence through greater business transparency will reduce the need for regulation. It is possible that a model of regulatory relief may be considered for those organisations demonstrating good performance[8].
- **Broadly Applicable**: the CRI is relevant to a wide range of organisations. It is currently completed by both public and private organisations and interest has been expressed by government organisations and non-profits. Furthermore, the creation of an integrated suite of tools associated with the CRI is currently under development which will facilitate uptake by both SMEs and 'starter' companies.

[3] Ernst & Young validate all submissions in Australia, except global submissions, which are validated by BITC.

[4] Please refer to www.corporate-responsibility.com.au for further information on the CRI in Australia.

[5] Companies formally invited to participate include the top 250 business enterprises listed annually in BRW magazine and members of the Business Council of Australia (BCA).

[6] Based on companies selected for inclusion in AMP Capital Investors Sustainable Future Australian Share Fund.

[7] AMP Capital Investors 'Financial Payback from Environmental and Social Factors', page 1.

[8] Current models exist (for example, EPA Victoria, ATO) whereby companies demonstrating better management of specific issues, and thus classified as lower risk, are subject to lighter scrutiny/regulation.

Improved performance is demonstrated

To date, the CRI has seen two cycles of measurement and reporting completed in Australia. In the second cycle, a number of companies demonstrated significant progress, reflecting both management and performance improvements. This is evidenced in the average scores of companies completing the CRI, on their Australian operations in both 2003 and 2004, which rose from 78.7% in 2003 up 4.3% to 83% in 2004. This was achieved despite the need for participating companies to overcome a challenging timeframe (the first two cycles were run only six months apart instead of according to the normal annual cycle). Furthermore, the value of the CRI as a gap analysis tool was demonstrated by the exemplary performance of one participating company which increased its results by over 15% to achieve a final silver-star rating within a six-month period.

Results for the 2005 CRI are due out on 15th May 2006. An initial analysis indicates that a similar trend in improvement is likely amongst continuing participants, demonstrating the CRI's usefulness as a management tool and framework.

Lessons learnt

The current model has been successful to date and could still work in its current form in the future. There would be advantages in developing the CRI so that the information it provides could also assist decision-making by regulatory bodies such as APRA, ASIC or the ATO.

However, participation in the CRI is yet to reach a critical mass. One of the significant implementation challenges currently faced is encouraging companies to participate in a voluntary, public benchmarking exercise for the first time.

The primary barriers to increased participation have been identified as:

- the need for broader market exposure – there is currently a lack of awareness and understanding regarding the CRI tool
- reticence by some businesses to partake in a voluntary public analysis and disclosure of their business practices
- the high level of resourcing needed to complete the CRI, particularly in the first year

Support from Government could assist to overcome these hurdles faced by first time participants through both encouragement of voluntary benchmarking and reporting, and supporting the development of transitional tools.

Costs

Implementation Costs

To date the costs of running the CRI project have been met by contributions from the three project partners: St James Ethics Centre; *The Sydney Morning Herald* and *The Age*; and Ernst & Young. The costs of the project to date, comprising partner contributions both in-kind and direct, have totaled $2,035,800.

It is envisaged that participation rates in the CRI will grow significantly over the coming years. The current model cannot support the proposed expansion of participants without additional funding.

In order to maximise the potential of the CRI project and ensure its sustainability, St James Ethics Centre has asked the Federal Treasurer, the Hon. Peter Costello MP, to consider a request that the Commonwealth Government invest in transitional funding during a three year period after which the process would be self-funded by business.

Transitional funding would provide support for:

- projected core costs that are expected to increase significantly with an increase in the number of participants
- employment of additional staff to support project implementation
- addressing identified barriers to entry
- the creation of an integrated suite of tools (relevant to organisations across the spectrum from starters to leaders) that can be used by all types of business and by other organisations (including government and non-profit organisations)
- the transition to a self-funding model

Participation Costs
Participation for organisations in the CRI is currently free of charge. Presently the expense incurred by participating companies relates solely to internal costs of both time and resources required to complete a full CRI submission. Whilst there is therefore a significant cost associated with first year participation[9], this has been shown to reduce markedly in subsequent years. Current participants have estimated that costs in subsequent years reduce annually by approximately one third[10]. For this reason in particular it would be pertinent for Government to examine ways to facilitate first year participation.

In transitioning to a self-funding model it is anticipated that in the future there will be an annual cash cost required from companies to participate, related primarily to funding the validation of their submissions, likely to be in the realm of $5,500 per company. In addition, there will be ongoing internal costs associated with participation. However, in a world where assurance of non-financial matters is growing steadily in importance it is probable that these costs would be incurred in any case. The CRI would therefore bring significant additional value to an existent cost.

In conclusion

Currently there is no one standardised, voluntary reporting tool in the market. Government leadership in this area, through active engagement and support for the role of business benchmarks such as the CRI, can assist in resolving the current confusion and allow for coordination of the voluntary efforts made by corporate Australia. It will also lead to greater transparency and comparability for users of this information.

Thank you for taking this initiative into consideration in examining how Australian companies should be encouraged to adopt socially and environmentally responsible business practices. Please feel free to contact me should you have any further questions or if I can be of any assistance in your deliberations.

Regards,

Dr Simon Longstaff
Executive Director
St James Ethics Centre

[9] Companies have indicated that it takes between three to ten weeks to complete a first CRI submission dependent on the internal availability of data/information, the complexity of operations, and the sophistication of current corporate responsibility practices and reporting mechanisms.

[10] This year updates have been made to the CRI tool allowing for an automatic transfer of data between years. This has allowed past participants to simply update previously entered information and has significantly reduced the time involved. This is reflected in the increased retention rate of participants submitting in Australia from 2004-2005.

st james ethics centre

28 September 2005

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

Dear Sir

Re: Inquiry into Corporate Responsibility

I am writing in response to your letter of 30 June 2005 seeking submissions to an inquiry into corporate responsibility and triple-bottom-line reporting in Australia. This written submission makes brief comments in relation to each of the terms of reference adopted for this inquiry.

Unless specifically indicated to the contrary, all comments refer primarily to 'for profit' incorporated entities.

In this submission, a 'stakeholder other than a shareholder' is stipulated to mean, "any person, group or entity on whom a corporation depends in order to pursue its objectives". This is a narrower definition than sometimes employed (one alternative is to include all persons affected by a corporation's operations). However, one benefit of this narrower definition is that it confers basic parity to the enabling roles played by shareholders and other stakeholders. Each class of stakeholder is seen to make a material contribution to the corporation (shareholders provide capital, employees provide labour, the community provides basic infrastructure and a 'license to operate', and so on).

a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

While individual decision-makers will vary in their personal regard for stakeholders other than shareholders, the vast majority of people, when acting in their role as a corporate decision-maker, will consider the interests of stakeholders other than shareholders as being entirely subsidiary to those of shareholders. The reasons for this are twofold. First, the legal obligation to act in the best interests of the company as a whole is often (and somewhat problematically) reduced to being nothing more than the financial interests of shareholders. In more extreme cases, this view can lead to a total disregard for a broader range of stakeholders who simply do not 'exist' in the mind of the corporate decision-maker.

Second, the established history of thinking about this question, in Australia, has always considered a regard for stakeholders other than shareholders as a means to an end – namely, to fulfil a principal duty to shareholders. In its most enlightened form, the duty to shareholders has been described as a duty "to shareholders in perpetuity" – and this formulation has been argued not merely to permit but actually require a concern for a broader range of stakeholders. However, as noted above, the status of stakeholders other than shareholders is entirely derivative. If a concern for their interests were not ultimately in the interests of shareholders, then they would be of no concern to the corporate decision-maker. The classic expression of this perspective was articulated by the one-time 'doyen' of Australian company directors, Sir John Dunlop, who observed in 1987 that:

> I put it to you that the directors are responsible to the shareholders for profit in perpetuity; and that this general expression of a principle permits, indeed **requires**, directors to pay full regard to their employees, to labour relations generally, to the community, to the country, in all their decisions for and on behalf of shareholders.
>
> (Dunlop, 1987, p 7, my highlighting)

b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

It is our view that any remarks about this issue must be considered in the context of the legal privilege of limited liability. It is remarkable that such an extraordinary privilege should have come to be so much taken for granted. Yet, the British House of Commons required more than 50 years of debate before it could be convinced that such a privilege should be enacted. It is easy to see why a democratic polity and its parliament would require such a long period of deliberation. The proposition that an initial investment should be allowed to generate an unlimited return (by way of dividends and capital gains) is, by itself, reasonably uncontroversial. However, it becomes profoundly challenging when linked to the proposition that irrespective of the damage done by a corporation – lives broken, environments ruined, and so on ... the extent of the relatively fortunate investors' liability will be limited to the value of their initial investment. That is, all the upside of corporate activity would be 'privatised' while all of the downside would be 'socialised'. The only basis on which a democratic legislature could enact such a law (and then allow it to continue) would be on the assumption that to do so would lead to an increase in the stock of what might be called the 'common good' (or at the very least not a decrease). That is, the legislature would need to be convinced that those enjoying the privilege (and their agents) would exercise their privilege in a manner that would make us all better off. Given this, we might expect company directors to have a proper concern for the effect of their decisions on people and entities other than shareholders alone – if for no other reason than it would be a profound breach of their duty to shareholders if their actions caused the parliament to qualify or withdraw the privilege (something that parliament could do at any time) in response to community outrage.

As will be noted, the point sketched above falls short of saying that company directors must recognise a direct duty to stakeholders other than shareholders. The argument is still couched in terms of the interests of shareholders. However, it is possible to go further in an analysis of the privilege of limited liability. The privilege is accorded to shareholders as individuals and not to the company as such. Thus, any implied obligations attached to the privilege fall on the shoulders of individual shareholders. However, the privilege enjoyed by shareholders cannot be enjoyed in isolation.

The whole point of the arrangement is that the privilege comes into effect when individuals aggregate their capital in companies. It is at least arguable that when shareholders aggregate their capital (and the privilege of limited liability), they also aggregate the implied duty not to use the privilege in a manner that is destructive of the common good. In these circumstances, company directors should be seen as effective agents for shareholders – with a responsibility for stewardship of their obligations as well as their rights.

An alternative reason for thinking that corporate decision-makers might have regard to the interests of stakeholders other than shareholders can be seen to emerge from the definition of ‘stakeholder’ stipulated above. That is, to the extent that stakeholders enable a corporation to pursue its objectives, so it is just that their interests be considered. There is no reason, in principle, why the suppliers of capital should be the only group to command the attention of corporate decision-makers. While it is true that the law confers certain rights on owners (shareholders) it is capable of recognising other rights (employees’, creditors’ etc.).

Some corporate decision-makers recognise these broader obligations but claim that they are not qualified to form a view about what might (or might not) constitute the ‘common good’. Rather, they argue that this is the role of governments – and the democratic process. Consistent with this view, they argue that they should have a clear focus on acting within the law – nothing less and nothing more. On this view, it has been argued that if a certain course of action is in the interests of the company and not illegal then it is at least permitted and probably required.

There are two problems with this position. First, it invites an increase in regulation and surveillance as the only means available for regulating corporate conduct. Second, it risks the creation of community scandal and calls for some qualification or repeal of the privilege of limited liability.

Perhaps a better point to be made in defence of the *status quo* is that it would be impractical for corporate decision-makers to be required to base their decisions on a calculation of the interests of stakeholders (as a whole) other than shareholders – not least because it is conceivable that the interests of stakeholders may prove to be fundamentally incompatible. In these circumstances, corporate decision-makers might become paralysed – having to choose between two or more incommensurate duties of equal ‘weight’. Our view is that this objection can be overstated. Corporate decision-makers need to be adept at balancing competing interests. That said, it is possible (and maybe even likely) that a stalemate could be reached. In these circumstances, we would agree that the interests of shareholders should take precedence.

In the end, what is needed is a balance of approaches. Individual companies should not be required to develop a comprehensive view of the ‘common good’. However, nor should they be indifferent to the effects of their actions. If there is *prima facie* evidence that a company’s actions are causing (or are reasonably likely to cause) harm, then corporate decision-makers should be required to take this into account in their deliberations and then be entitled to allow such considerations to inform their decisions. The distinction in the last sentence should be noted – and is indicated by highlighting (underlining) key words.

None of this should be taken to mean that incorporated entities should become financially unsustainable. It is conceivable that a company could do so much harm as to make it desirable that it cease to exist. However, this should be considered the true exception.

c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

As noted above, the primary legal duty of a company director is to act in the best interests of the company as a whole, free from conflicts of interest etc. Some commentators and practitioners have argued that the duty to the company is coextensive with that owed to shareholders. However, this is probably only so if you take Dunlop's view that the duty is to shareholders in perpetuity.

There are two problems with the current position. First, the law is not clear about the extent to which the duty of directors is to shareholders 'in perpetuity' – or to those holding shares at a particular point in time. Second, although it will sometimes (or often) be the case that there is an alignment between the interests of shareholders and other stakeholders, there is absolutely no reason to think that this is necessarily or always so. As such, it is conceivable that corporate decision-makers may find themselves doing great harm to stakeholders in conditions where the objectively assessed risks of harmful consequences flowing from this action are negligible.

d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

We do not support recommendations to make it compulsory for company directors to base their decisions on the interests of stakeholders other than shareholders.

However, we think that company directors should be required to consider those interests – even if in the end they opt to act exclusively in the interests of the company as a whole[i].

Finally, we would recommend an amendment to the Corporations Act, similar to the provisions relating to the 'business judgement rule', allowing company directors to make decisions based on *bona fide* ethical considerations (including but not limited to the interests of stakeholders other than shareholders) – and protecting them from liability for doing so when a reasonable person would judge those considerations to be well founded. This protection should be afforded in all cases – including when the decision may have some detrimental effect on the financial interests of the company as a whole, its shareholders or some group of them. As such, directors relying on the 'ethical judgement rule' as a defence, would be required to produce documents demonstrating the quality of the reasoning employed in reaching their decision. Courts would only be entitled to review the substance of any decision if the quality of the decision-making process was first found to be inadequate.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

We believe that the use of legislation, regulation and surveillance as the principal means for protecting the interests of stakeholders other than shareholders is misguided. Our concerns are twofold. First, an over-reliance on such an approach is largely ineffective because it invites a negative culture of compliance characterised by indifference to the principles that inform the legislation or regulations. In these circumstances, corporations become adept at playing a game of 'regulatory arbitrage' – across jurisdictions and through the exploitation of loopholes.

Second, we believe that an over-reliance on regulation and surveillance can inadvertently weaken the ethical sinews of society. When people comply by merely 'ticking the box', then they are absolved (or absolve themselves) of any responsibility for choosing to act in a manner that is right and good. One of the unintended consequences of a system designed to ensure that people cannot choose to do what is 'wrong' is that they can no longer choose to do what is 'right'. They no longer choose at all – they merely comply. This weakening of the ethical sinews of society generates considerable, latent risk. If for any reason the regulations fail, the lack of underlying resilience can lead to a broad failure of responsible conduct.

It is for these reasons that we recommend the encouragement of corporations to participate in voluntary exercises such as the Corporate Responsibility Index (CRI). St James Ethics Centre is the 'trustee' for this instrument in Australia and New Zealand. Developed in the United Kingdom, the CRI provides a highly effective tool for measuring corporate performance across dimensions that necessarily require a consideration of interests other than those of shareholders. The most important features of the CRI are that it offers detailed information that helps corporations to improve their actual performance. Secondly, the reporting process leads to the publication of an Index available for examination by the broader community. Along with the Dow Jones Sustainability Index (DJSI) we believe the CRI provides a powerful tool for encouraging an underlying culture of corporate responsibility.

As noted below, we think that government has an important role to play in encouraging and supporting businesses that voluntarily undertake valid and credible steps to measure, report on and improve their performance in the overlapping areas of corporate governance and responsibility. Businesses undertaking these commitments should be eligible for 'regulatory relief' – moving from highly prescriptive regimes to a 'principles based' system of co-regulation. The community may require the maintenance of a more prescriptive regulatory regime where companies opt not to adopt voluntary programs of the kind outlined above.

Further details about the operation of the CRI can be found at www.corporate-responsibility.com.au

f) The appropriateness of reporting requirements associated with these issues.

For reasons outlined above, we support the development of a voluntary initiative by which business reports on its performance in the field of corporate responsibility. However, it should be noted that a voluntary scheme may not succeed. Given this, government should consider asking the ASX and ASIC to deliver minimal and mandatory reporting standards – which would ensure that, without specifying the form of reporting, all annual reports, at a minimum, included basic information about corporate responsibility – if not at the level required by instruments such as the CRI.

Most importantly, Government should consider providing positive incentives to corporations that voluntarily participate in programs like the CRI and DJSI – for example government might offer some regulatory relief to companies able to demonstrate a credible commitment to the principles of corporate responsibility and their application.

Finally, government might consider making available some modest financial assistance to corporations needing to employ additional resources so that they can improve their performance across the field of corporate responsibility. Funding would be available for a limited period of time to allow for the purpose of capacity building.

g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

No specific comment to make other than to draw the committee's attention to the UK's Operating and Financial Reporting (OFR) review.

Please feel free to contact me if I can be of any assistance in your deliberations.

Yours sincerely,

Dr Simon Longstaff
Executive Director
St James Ethics Centre

Reference:

1. Dunlop, Sir John, (1987) "The Responsibility of Company Directors: Formulation of the Major Policies of The Company" in, *Dunlop on Directors*, Sydney, The Institute of Directors in Australia.

[i] It should be noted that recent decisions by Finkelstein, J. and Emmett, J. in the Federal Court have introduced a further 'wrinkle' in contemporary understanding of what is meant by "the company as a whole". In ordinary commercial language this is taken to include the company as a legal person and all of its shareholders. The recent decision implies that the duty to act in the interests of the company as a whole, arising under the Corporations Law, may only apply to those shareholders who purchase shares through an initial subscription of capital – and not those who have purchased shares 'on market'. One practical effect of this decision has been to allow some shareholders to rank with creditors when suing companies in liquidation. There are, of course, further implications in terms of the broad duties of directors discussed in this submission.

AUSTRALIAN CONSERVATION FOUNDATION

27 February 2006

Submission to the Corporations and Markets Advisory Committee Reference on Corporate Social Responsibility

INTRODUCTION

The Australian Conservation Foundation (ACF) welcomes the opportunity to respond to CAMAC's discussion paper on Corporate Social Responsibility. As ACF has already made an extensive submission to the Parliamentary Joint Committee on Corporations and Financial Services on this topic, rather than repeating the information and arguments set out in that submission (referred to throughout as the "ACF PJC Submission"), we attach a copy of it and refer to it throughout this submission where relevant.

The ACF PJC Submission outlined a series of 11 reforms designed to encourage improved corporate environmental performance in Australia. The purpose of this submission is to address additional matters identified in CAMAC's Discussion Paper and to highlight how the reform proposals in the ACF PJC Submission are relevant to this inquiry. The two submissions should be read together.

In our view, the legal and practical influences on corporate managers, directors and shareholders must be considered as a whole system in order to align the incentives of corporate decision-makers to promote ecologically sustainable development. In this sense, focusing too heavily on the duties of corporate directors could obscure the need for improvement to corporate incentives in a range of other areas. While we support clarification of directors' duties, the interrelationships between different drivers that act on corporate decision-makers mean that a change to only one element, such as directors' duties, is unlikely to result in significant behavioural change.

PART 1: THE ISSUE OF CORPORATE SOCIAL RESPONSIBILITY

How might corporate social responsibility usefully be described for working purposes?

Page 3-4 of the ACF PJC Submission outline ACF's views on how best to understand the term "corporate responsibility". However, we also urge caution in the use of this term. Discussions of "corporate responsibility" or "CSR" frequently bog down from the start in unproductive disputes about definitions and terminology, and often progress no further. Questions such as “What business activities are responsible?” and “Who is a stakeholder?” invite answers based on *a priori* or subjective viewpoints, rather than clear reasoning from basic principles.

A better starting point for a constructive discussion of the behaviour of economic entities is a statement of first principles about the purpose of economic activity and business organisations. The following statement is one example:

> *The economy of a society, and the business organisations that constitute that economy, should operate to maximise the wellbeing of society over a timeframe that extends indefinitely into the future.*

The “wellbeing” of a society in this sense should be understood broadly, encompassing both the provision of material goods and the degree to which immaterial needs and desires – such as happiness, security, community and family, health, leisure, justice and equity – are satisfied. The interests of Australian society would include both current and future Australians, as well as Australia’s interaction with the global community. Further, the interests of nonhuman species are encompassed as an element of societal welfare, whether one views such interests as intrinsically worthy or merely as instrumental to other human interests. Ecological health and sustainability is an important prerequisite for the achievement of all of the above elements of societal welfare.

We fully acknowledge that there are many possible expressions of such a first principle. Nevertheless, we believe there is greater degree of consensus about the ultimate purposes of economic activity than there is about, for example, what business activities are “responsible”. Proceeding from an agreed principle may serve to unlock the debate about corporate “responsibility” and lead to a better assessment of whether specific business practices are desirable or undesirable (rather than “responsible” or “irresponsible”), and whether specific regulatory or other changes should be adopted.

The above expression of a possible first principle immediately suggests a number of key questions about current Australian economic activity:

- To what extent do the activities of Australian business entities, individually and as a whole, operate to maximise the wellbeing of Australian society?

- What features that shape the conduct of Australian business entities might discourage or inhibit them from engaging in desirable activities that maximise societal wellbeing?

- What could be done differently to align the incentives and activities of Australian businesses to be consistent with long-term societal wellbeing?

We address each of these, briefly, in turn, focusing on the interaction between business activities and the environment.

To what extent do the activities of Australian business entities, individually and as a whole, operate to maximise the wellbeing of Australian society?

While it is apparent that much business activity is positive and contributes to societal welfare in the long term, it is equally apparent that there are a great many instances where business enterprises have conducted themselves to our collective detriment. A number of examples are set out on pages 5-9 of ACF's PJC Submission. Those are not mere historical aberrations; corporate malfeasance continues apace. If proactively sustainable initiatives are increasingly a feature of business-as-usual in Australia, then so are activities that damage our environment and communities. For example, just since CAMAC commenced this review:

- A New South Wales waste disposal company was convicted of deliberately sending hazardous, carcinogenic waste to landfill. The NSW Land and Environment Court found that the company's conduct was "deliberate, calculated and undertaken for financial gain with complete disregard for public safety or the environment."

- A major Australian bank was found by the Federal Court to have violated the rights of its workers, and in doing so to have acted "solely in pursuit of its self interest and profit … without proper regard for the legality of its conduct."

- A small Australian resources company operating a gold mine in the Philippines incurred a financial penalty and had its operations suspended (which continues as of this writing) following toxic cyanide spills from a tailings dam, which caused widespread fish kills and serious damage to local economies and the environment. The spills were a result of heavy rainfall, an eventuality one might have anticipated in a tropical area. Environmentally devastating cyanide spills and toxic contamination of groundwater are a recurrent feature of gold mining around the world.

These examples and others provide a window into the motivations and effects of at least some of our corporations. An instance of more widespread business activity that is not in our collective long-term interest is the ongoing contribution of Australian businesses to global climate change. Despite a growing consensus that cuts in greenhouse emissions of at least 60% by 2050 is necessary to avoid dangerous climate change, the historical and ongoing lack of consequences for businesses that do not reduce their emissions in Australia has meant that many businesses have made little headway in moving to sustainable levels of greenhouse pollution. Further, many energy intensive industries and companies in Australia have actively and vigorously opposed the introduction of public policy measures that would address the problem effectively.

One interesting insight into how widespread these issues are is given in a recent survey conducted by CPA Australia, entitled *Confidence in Corporate Reporting 2005.* As part of that study, two hundred Australian CEOs, CFOs and company directors were asked a range of questions about a variety of corporate practices. Only 54% of those corporate executives agreed with the statement, "Australian company directors have adequate regard for the interests of all stakeholders". Unsurprisingly, a much lower proportion of the general public – only 35% – agreed with the statement.

The fact that only a bare majority of Australian corporate executives themselves think that the interests of all "stakeholders" are adequately regarded by Australian companies suggests a deep malaise. The survey implies that it is not merely a few exceptionally poor performing or criminal corporations that are the problem, but instead that there are structural flaws that inhibit companies generally from acting in the best long-term interests of our society.

What features that shape the conduct of Australian business entities might discourage or inhibit them from engaging in desirable activities that maximise societal wellbeing?

There are a large range of drivers of corporate behaviour that affect how businesses relate to the environment. The formal duties of directors, which are the focus of the reference to CAMAC, are only a relatively minor component of the overall system of incentives. Some of the key drivers of ecologically unsustainable corporate behaviour are as follows:

- Limited liability. The ability of investors to shield themselves through corporate entities from liabilities they would otherwise bear allows them to externalise environmental and other risks. This encourages excessive environmental risk-taking, since investors can reap the full rewards of risky environmental practices without having to bear the full costs. Limited liability is a massive intervention in the free market, a market distortion that leads to moral hazards (in the economic sense of that term) on a vast scale.

- Compensation structures of corporate executives. Because senior corporate managers are typically remunerated on the basis of short- and medium-term earnings and stock performance measures, they have an overriding financial incentive to maximise short-term performance at the expense of long-term sustainability.

- Short-term investment market focus. Analysts, fund managers, asset consultants, and investors are similarly focused on very short-term measurement and assessment cycles. Issues such as long-term environmental risks and opportunities are strongly deemphasised if investment markets do not look beyond a short time horizon.

- Government policies that skew environmental choices. A range of government tax, spending, research and other incentives reward environmentally suboptimal corporate behaviour. For example, depreciation rules favour the maintenance of old, polluting equipment rather than investment in new, cleaner technology. Tax incentives and other support for fossil fuel exploration, production and consumption are particularly pronounced.

- Failure to price negative externalities. Existing laws may provide no incentive for companies not to damage the environment. The best example is the ongoing failure of Australia to place a price on the emission of greenhouse pollutants.

- Imperfect and asymmetric information about environmental performance. The lack of consistent and reliable information about the environmental consequences of business activities inhibits formulation of sound public policy, investment market efficiency, and the ability of civil society and investment market to monitor corporate activities.

- Legal duties of corporate directors and trustees of institutional investors. The current expression of directors' duties and trustees' duties may constrain companies from fully accounting for long-term environmental issues, particularly where the company is legally imposing externalities on others.

What could be done differently to align the incentives and activities of Australian businesses to be consistent with long-term societal wellbeing?

The 11 reforms outlined in the ACF PJC Submission, and the additional suggestions in the bulk of this submission, answer this question. They seek to address each of the drivers of unsustainable business behaviour outlined above.

The regulation of business organisations should proceed from the principle that the goal of economic activity is to further the wellbeing of society, broadly construed.

Features of the regulatory and business structure that inhibit the achievement of that goal include limited liability, short-term executive and investment performance assessment and remuneration, tax and other government incentives, failure to price environmental externalities, imperfect information, and legal duties of directors and trustees.

Reforms should address each of these fundamental drivers of unsustainable business activity.

PART 2: DIRECTORS' DUTIES – THE CURRENT POSITION

ACF has no comments on the substance of the account of current directors' duties in Australia, which is both thorough and accurate.

We note, for the sake of clarity, that under the usual interpretation of directors' duties, directors are prohibited from considering the interests of non-shareholder constituencies *except* where such consideration furthers the interests of the shareholders. The "consideration" of non-shareholder interests under this view is strictly derivative of the overriding obligation to act in the interests of the shareholders. Non-shareholders are mere instruments for the maximisation of shareholder gain.

If directors may consider non-shareholder interests only when, and only to the extent that, they are really maximising shareholder value, it would be a logical fallacy of the first order to say that there is any meaningful scope for "consideration" of non-shareholder interests. The assertion is hollow double-speak. In the event of any real conflict between shareholder and non-shareholder interests, the current dominant interpretation of the law prioritises shareholders absolutely.

We note further the apparent lack of any Australian case in which a director has been found to be in breach of his or her duty, where such breach did not involve some element of fraud, self-dealing or negligence. This suggests that shareholders never actually enforce the formal directors duties as a means to ensure directors act only in the interests of shareholders and not other constituencies. This means either that directors never violate the rule at all or, more likely, that shareholders much prefer to rely on other mechanisms of shareholder control, such as power over appointments and removals and control of remuneration of board members. No doubt the business judgment rule makes legal action for a breach of duty (not involving fraud, self-dealing or negligence) very difficult to make out. The frequently asserted dangers that widening directors duties will lead to a loss of management accountability would seem to be greatly exaggerated – after all, it is not a mechanism of accountability that is currently widely used.

PART 3: DIRECTORS' DUTIES – MATTERS FOR CONSIDERATION

Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties?

As discussed on pages 12-19 of the ACF PJC Submission, ACF favours a pluralist approach to directors' duties. Many groups contribute to the success of the modern corporation, and it is inappropriate and unjust to prioritise the interests of one specific group of financial investors over the interests of those individuals, groups, and communities that contribute other forms of financial capital, labour, and environmental and social capacity. More to the point, such prioritisation of shareholder interests narrows the ability of a corporation to contribute to overall societal wellbeing.

The strongest argument in favour of such an approach, and the best rebuttal against arguments defending shareholder primacy, is the fact that continental European corporations have quietly gone about their business for centuries without any notion of shareholder primacy.

This is not to ignore the differences in history and structure among continental and Anglo-American corporate practices. However, one must concede that European company directors are not noticeably wracked by indecision over how to reconcile competing interests, nor rampantly unaccountable to their constituencies. It is regrettable that the discussion paper does not examine the continental system of directors duties. The various arguments advanced in defence of shareholder interests should be carefully weighed up against real practice in civil law jurisdictions.

ACF does not support a minor adjustment of directors' duties that would more clearly express the "enlightened shareholder value" notion. While we have no doubt that enlightened shareholder value is better than unenlightened shareholder value, such a clarification would retain the absolute primacy of shareholder financial interests over all others in the event of any conflict.

If a pluralist approach were to be adopted:

- **Should directors be permitted to take into account the interest of specific classes of stakeholders or the broader community when making corporate decisions, or alternatively should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?**

Directors should be required to take into account the interests of shareholders and other constituencies when making corporate decisions. If the duty was framed as merely permissive, the other existing measures of shareholder control – particular control over appointments and remuneration – would see to it that shareholder interests were prioritised. The availability of a statutory "safe harbour" defence for directors against shareholder suits if they consider non-shareholder interests will be of little comfort to a director facing dismissal by the shareholders for such action. What is needed is not simply a permissive safe harbour from lawsuits, but a positive obligation that offers directors a legal duty rather than a discretion, upon which they can rely in justifying their actions to shareholders.

- **In either case, what broader interests should be identified?**

ACF has suggested a list of interests including employees, financial investors, shareholders, customers and suppliers, communities in which the corporation operates, and the environment. These appear to encompass the groups that typically contribute substantially to the success of most business operations. This is broadly consistent with the groups identified in the laws of Germany (*investors, workers, suppliers, customers, consumers, state and society),* Vermont (*employees, suppliers, creditors* *and customers, the economy of the state, region and nation, community and societal considerations, including those of any community in which any offices or facilities of the corporation are located)* and other laws around the world.

- **How might any proposed amendment be implemented and enforced?**

The proposed amendment would operate to clarify that the word “corporation” in section 181 of the *Corporations Act* includes the broad set of constituencies. Further, provisions would have to be introduced to ensure directors who acted in the interest of the “corporation”, as broadly understood, can not be sued for breach of common law duties or oppression merely because their did not prioritise shareholder interests over others. The enforcement mechanisms in section 1324 are otherwise adequate, bearing in mind that the risk of an adverse costs award in Australia would be a substantial deterrent to frivolous litigation by non-shareholders.

Section 181 of the *Corporations Act* should be amended to clarify that corporate directors, in acting in the best interests of the corporation, must take into account a range of constituencies, including employees, financial investors, shareholders, customers and suppliers, communities in which the corporation operates, and the environment.

PART 4: CORPORATE REPORTING

Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities?

As outlined in the ACF PJC Submission on pages 30-33, current reporting by Australian entities on social and environmental issues (“S&E Reporting”) is sporadic, inconsistent, lacking in comparability and reliability, and well below international standards.

Voluntary reporting on environmental issues has failed: it has not been taken up meaningfully by more than a small fraction of Australia’s major businesses, with the result that Australian investment markets, consumers, governments and the community generally do not have the clear and comparable information they need to make good decisions about investment, consumption, and policy decisions.

We note that, while many corporations officially continue to oppose mandatory S&E Reporting, a majority of Australia’s senior managers privately think mandatory reporting would be a positive step. According to a survey by CPA Australia, 53% of 200 Australian Directors, CEOs and CFOs agreed that “The Government should mandate the reporting of companies’ social and environmental practices.”, while a resounding 88% agreed that such mandatory reporting would make companies more sensitive to their social and environmental impacts. More than 80% of the general public, shareholders and auditors, and 63% of analysts, advisors and brokers, also supported mandatory reporting.[1] Clearly this is an idea whose time has come.

Why is mandatory reporting of environmental performance and practices desirable?

As part of an interrelated package of reforms to encourage CSR, mandatory S&E Reporting harnesses market drivers that create incentives for firms to outperform their competitors as well as allowing shareholders to monitor the manner in which their managers perform their duties. Information in S&E Reports is required to make a proper assessment of the long-term risks and opportunities associated with a business. The efficient collection and analysis of such information is a core element of sustainability investment strategies, which are now pursued not only by specialist "SRI" funds but increasingly by mainstream funds as well. For example, funds manager Portfolio Partners has a detailed set of expectations around environmental reporting,[2] which most Australian companies do not currently live up to. Consistent and comparable information about environmental performance is essential to the benchmarking that allows sustainability investment strategies to realise their maximum potential.

Mandatory S&E reporting would ensure that positive sustainability performers can realise the full market benefits of their superior performance

In the 2005 KPMG Survey on CSR Reporting, 74% of respondents identified the main driver for producing a S&E Report was 'economic considerations', which were defined as reasons either directly linked to increased shareholder value or market share or indirectly linked through increased business opportunities, innovation and reputation, and reduced risk.[3]

However, the absence of a mandatory requirement to produce an S&E Report means that the economic benefits of reporting are reduced because companies that do prepare reports expose themselves to public scrutiny and criticism from which their less responsible peers are shielded. To compound the problem, the potential rewards for these companies are reduced if there is no basis on which their performance can be judged relative to other companies in like circumstances. Further, the credibility of all reports is reduced by the lack of any baseline of required disclosures. This *laissez-faire* approach means that companies can limit their reports to show their operations in the

[1] CPA Australia, *Confidence in Corporate Reporting 2005: Detailed findings*, November 2005, p. 23, available at www.cpaaustralia.com.au.

[2] See Portfolio Partners, *Corporate Governance Policy*, August 2003, available at http://www.portfoliopartners.com.au/Portals/0/Corporate_Governance_policy.pdf (esp. pp 10-17 on environmental reporting expectations).

[3] KPMG Global Sustainability Services and the University of Amsterdam, 'KPMG International Survey of Corporate Responsibility Reporting 2005' (2005) www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf, 18.

best possible light, rather than providing a true appraisal of the social and environmental impacts of their activities.

S&E Reporting corrects information asymmetries between shareholders and managers.

Shareholders are also prejudiced by the lack of consistent S&E Reporting requirements. A report commissioned by the United Nations Environment Program Finance Initiative on the materiality of social and environmental factors conducted by 11 major brokerage houses concluded that:

> Based on our own experience and the results of this research we see environmental, social and corporate governance issues as being an integral part of successful management in the modern world. We therefore strongly feel that they should be taken into account in financial analysis and in investment management.[4]

Requiring disclosure of an S&E Report will correct an information asymmetry that currently exists between shareholders and managers. Shareholders should be able to consider management's approach to dealing with S&E issues when they are assessing a company's value. If the amendment proposed above to directors duties is introduced, then the importance of shareholders being able to access to this information will be heightened. Without access to a clear and comparable report, shareholders are unable to conduct an accurate assessment of their managers' performance.

Mandatory S&E Reporting is essential for the analysis techniques utilised by SRI investors and, increasingly, mainstream investors.

A particular group of shareholders that are prejudiced by the absence of mandatory S&E Reporting requirements are those with a socially responsible or sustainable investment mandate. According to the 2004 Benchmarking Survey conducted by the Ethical Investment Association, the total funds invested in such products in Australia increased by 96% since the survey was first conducted in 2001.[5] Despite this growing trend, the ability of these funds to compete with mainstream investment options is hampered by the higher research costs associated with obtaining the information needed to perform their investment assessments. The introduction of mandatory social and environmental reporting would reduce these costs and allow SRI Funds to compete on a more level playing field. It is time that the regulatory structure supported

[4] UNEP Finance Initiative, 'The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing – Executive Summary' (2004) www.unepfi.net, p. 3.

[5] Deni Greene Consulting Services, 'Socially Responsible Investment in Australia – 2004' (2004) Ethical Investment Association, www.eia.org.au, p. 10.

the requirements of SRI funds as well as those of investors and fund managers who limit themselves to purely financial metrics.

Many SRI Funds have developed sophisticated questionnaires that they submit to companies in order to collect the information they need to perform their analysis of the company's value. The costs associated with operating these funds would be reduced if this information were readily available, thus enabling them to compete on a more level playing field with other funds.

Mandatory S&E Reporting is supported by a majority of corporate managers, analysts, shareholders and the public. The introduction of mandatory S&E Reporting would:

- **level the playing field among businesses by removing the unfair distortions that exist in the absence of a mandatory requirement;**
- **allow benchmarking of corporate performance on sustainability issues;**
- **provide clear information to investment markets, including SRI and mainstream investors;**
- **provide accountability to the community; and**
- **drive improved social and environmental performance.**

Which entities should be required to report?

There is no reason to limit reporting requirements to publicly listed companies. Non-public companies may also engage in activities with significant social and environmental effects. Subsidiaries of foreign companies in particular may be very large and have substantial effects on the Australian environment and society, yet they are not as exposed to the pressure of Australian financial markets.

In addition, those with an interest in such information include not only analysts and shareholders, but also consumers, suppliers of debt capital, employees, regulators and local communities. As the mechanisms used by these corporate monitors exist outside of the public capital market structure, they operate on both listed and unlisted companies. Therefore, there is no reason why S&E Reporting requirements should not apply to unlisted companies as well.

In the ACF PJC Submission, we suggested that in an incremental approach to S&E Reporting should be adopted, focussing initially on the 500 largest companies, whether publicly listed or not. This is a workable approach. Another possibility is to focus on the largest 100 companies and any other companies active in areas with high environmental or social impacts or risks. Various financial services companies have developed lists of high-risk sectors for their own purposes; these could easily be adapted to target reporting requirements to high-risk sectors, while minimising reporting requirements for industries with fewer risks and impacts. An example is the list of high environmental risk sectors developed by Portfolio Partners.[6]

Mandatory S&E Reporting requirements could initially apply to the largest Australian companies, and/or to companies active in industry sectors with high social and environmental risks.

Mandatory S&E Reporting should not depend on the listing status of the company, since nonlisted companies may have significant environmental and social impacts. Companies with comparable impacts and risks should be subject to equal scrutiny, regardless of their capital structure.

What key features should S&E Reporting requirements reflect?

Clarity and comparability

The importance of ensuring clarity and comparability has long been recognised in respect of financial information if reports are to fulfil their role, and the same should apply to S&E Reports.

Benchmarking acts as a significant incentive for companies to improve their performance. This is clearly demonstrated by the operation of the financial markets, where the incentive to improve financial performance is the result of market forces and competition, rather than any obligation to increase profits.[7]

These same principles apply to S&E Reports. For S&E Reporting to act as an effective tool to encourage companies to improve their performance, it is imperative that discrepancies in reporting practice are eliminated. As stated in the EU review of reporting requirements in 2001:

> "Companies will only compete on environmental performance (as well as on price and quality) if high-quality information is freely and easily available to the market. Transparency and information are prerequisites for environmental competition."[8]

The purpose of any reporting requirement is to ensure that those in a position to monitor a company are able to do so on the basis of pertinent and reliable information.

[6] Portfolio Partners, *Corporate Governance Policy*, August 2003, available at http://www.portfoliopartners.com.au/Portals/0/Corporate_Governance_policy.pdf, p. 17.

[7] See Sean Gilbert, 'The Transparency Revolution' (2002) (November/December) *The Environmental Forum* 18, 20; and John Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed, 2005) 31.

[8] EC Environment and Climate Research Program "Measuring the Environmental Performance of Industry: Final Report", February 2001, page 206. Available at: http://cleantech.jrc.es/docs/MEPI%20FinalReport.pdf.

As identified in the Discussion Paper, there are a number of people and groups who use a range of formal and informal mechanisms to act as corporate monitors.[9] In the case of monitoring social and environmental performance, the role of groups other than shareholders is of heightened importance, because it may be those groups rather than shareholders that bear the brunt of any negative environmental or social impacts. is even more important than it is with respect to financial information.

External verification of reports

Again, the same principles that apply to financial reporting should also apply to S&E Reporting. If investors and other corporate monitors are to have confidence in the information with which they are provided, then a procedure for verifying the integrity of S&E Reports is imperative. External verification would also reduce reliance on government regulators to monitor the reporting practices of entities.

We note that 77% of corporate managers and 84% of analysts, advisors and brokers agree that S&E Reporting is worthwhile only if subject to an external audit.[10]

In addition to verification, effective penalties for inaccurate reporting must be established to reinforce the credibility of S&E Reports.[11] These should again be analogous to the enforcement mechanisms applicable to financial reporting.

Mandatory S&E Reporting should ensure clarity and comparability of substantive content, should be externally verified with appropriate penalties for inaccurate reporting.

What substantive environmental disclosures should be required?

Global Reporting Initiative

Requiring companies to produce a report according to a set of common guidelines, such as the GRI Guidelines, would be an effective way to ensure that the market is fully informed about the social and environmental risks associated with all companies in a manner that allows it to identify the top performers. The GRI Guidelines are an appropriate standard because they are readily adaptable to different industry sectors and include sector-specific supplements. In addition, they were developed and

[9] As noted in the Discussion Paper, the Australian Accounting Standards Board recognises that financial reports are for the use of a *'range of stakeholders, including investors employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public'.* Australian Accounting Standards Board, *Framework for the Preparation and Presentation of Financial Statements* (July 2004) paragraph 9, cited in Discussion Paper at page 80.

[10] CPA Australia, *Confidence in Corporate Reporting 2005: Detailed findings*, November 2005, p. 23, available at www.cpaaustralia.com.au.

[11] Jason Scott Johnson, 'Signalling Social Responsibility: On the Law and Economics of Market Incentives for Corporate Environmental Performance' (Version current at 11 May 2005) *University of Pennsylvania Law School Papers Series*, available at lsr.nellco.org/cgi/viewcontent.cgi?article=1070&context=upenn/wps.

continue to be developed with significant business and non-business input. This tends to lead to an appropriate balance between the needs of those who use S&E Reports and those who are responsible for their preparation.

The GRI Guidelines have the additional advantage of coming into widespread use around the world. By adopting them, the compliance costs for multinational companies could be reduced across jurisdictions. As has been done in South Africa, it may be appropriate to excuse companies from reporting against some of the GRI indicators, provided an adequate explanation as to why the indicator is not relevant to the company's operations was provided.[12]

The appropriate provision in which to include an S&E reporting requirement would be section 299(1)(f) of the *Corporations Act 2001.* This section should be replaced by a general obligation to address each of the GRI indicators, either in the directors' report or by reference to a stand-alone report. In both cases, the S&E Report should be considered part of the Directors' Report for the purposes of auditing requirements.

Specific indicators

In the event that a narrower set of mandatory disclosures is deemed advisable, ACF would recommend the following environmental indicators as the most important and most widely applicable:

- Absolute quantity of greenhouse emissions;
- Absolute amount of energy used;
- Absolute quantity of water used;
- Legal compliance report, including a description of any violations of any applicable laws (including licenses) and any matters that may give rise to civil liabilities; and
- Qualitative discussion of key environmental liabilities, risks and opportunities

For the first three of these indicators, minimum thresholds could be developed so that companies with very low impacts in any category would be exempt. Companies would of course be free to supplement the absolute levels disclosed with appropriate intensity measures.

The legal compliance report is important not only because non-compliance can lead to material penalties, but equally because compliance with law is a good indication of the

[12] This approach has been adopted in South Africa in accordance with the report of the King Committee on Corporate Governance. See www.ifc.org/ifcext/corporategovernance.nsf/Content/SouthAFrica.

quality of management. While an accumulation of minor breaches may not be directly material in a financial sense, it is not unreasonable to think that they provide investors with an important window into the operations of a company and the likelihood of more serious liabilities down the track.

Reporting requirements should be amended to include a general obligation for companies to report against the GRI guidelines.

If a narrower set of disclosures is deemed advisable, disclosure should at a minimum include greenhouse gas emissions, water use, energy use, a comprehensive legal compliance report and a qualitative discussion of key environmental liabilities, risks and opportunities.

PART 5: ENCOURAGING RESPONSIBLE BUSINESS PRACTICES

The heavy focus of the Discussion Paper on reform of directors duties and reporting requirements follows, plainly enough, from the terms of the reference to CAMAC. While these are important issues, it is regrettable that discussions of corporate responsibility focus so heavily on these two concerns, often to the near-total exclusion of other equally or more important drivers of unsustainable corporate behaviour. As set out in the introduction, the fundamental drivers of unsustainable corporate activities include a wide range of government and market incentives, each of which should be examined for ways of better aligning corporate and long-term societal wellbeing.

We believe that the Government’s role in promoting corporate activity that furthers the long-term wellbeing of society should include government initiatives that:

- ensure the full pricing of environmental externalities in corporate decision-making (taxation, fees and market-based mechanisms, such as emissions trading)

- steer investment away from unsustainable activities and towards sustainable activities (taxation, subsidies, research, and infrastructure policies)

- encourage a long-term focus in investment markets (capital gains taxation; trustees’ duties)

- align the incentives of corporate entities and their managers to long-term societal interests (executive remuneration)

- regulate the interaction of various corporate constituencies in a way that best promotes social wellbeing (corporate law)

- ensure market transparency on the environmental and social performance of companies (disclosure)

Each of these areas, and probably many others, merits full consideration at a level of detail comparable to the treatment of directors' duties in the Discussion Paper. Possible reforms in each of these areas are outlined in the ACF PJC Submission.

To those reforms, we add one additional proposal, related to the excessive short-term focus of Australian capital markets. The problem of short-termism has been diagnosed with great depth of understanding and precision by the Business Council of Australia in its 2004 Report, *Beyond the Horizon: Short Termism in Australia.*[13]

The short-term focus of investment markets means that issues that play out over longer time frames, such as environmental risks and opportunities, tend to be undervalued or even ignored completely. For example, at a recent conference on the importance of water issues in investment decision-making, a senior representative of BHP Billiton explained that the company holds a seminar every year to discuss with industry analysts its sustainability performance and initiatives. While invitations are sent out widely, mainstream investors and analysts simply do not show up; the seminar is attended almost exclusively by specialist sustainability analysts and investors.

The trend towards short-term performance and monitoring is exacerbated by the steadily decreasing average holding period of investments. In the mid-1960s, the average holding period for an investment was around 7 years, while today it is less than one year for managed investment funds.[14] As funds churn their investments at an ever-accelerating rate, investors bear the costs in terms of increased transaction costs, lower returns and decreased attention to long-term business and economic performance.

One solution to this problem would be to recalibrate the rates of capital gains taxation to encourage longer holder periods for investments. If the rate of CGT payable on an investment decreased the longer the investment was held, investors would have a real incentive to invest for the long term, rather than seeking to profit off of short-term market volatility. Such long-term investors would have a greater incentive to engage proactively with companies to improve their performance, and would tend to lessen the intense pressure on corporate executive to generate immediate improvements in earnings, often at the expense of longer term business strategy and investment.

[13] Available at http://www.bca.com.au/upload/Beyond_the_Horizon_-_Short-Termism_in_Australia.pdf.

[14] Alfred Rappaport, "The Economics of Short-Term Performance Obsessions", *Financial Analysts Journal* May/June 2005, Vol. 61 No. 3, p. 65-66.

Conclusion

ACF would be pleased to provide any additional details or clarification on the matters set out in this submission or in the ACF PJC Submission.

END

For more information, please contact
Charles Berger
Legal Adviser
Ph: (03) 9345 1173
email: c.berger@acfonline.org.au

FLOOR ONE, 60 LEICESTER STREET **CARLTON VIC 3053**
phone ■ **03/ 9345 1111** // facsimile ■ **03/ 9345 1166**
email ■ **acf@acfonline.org.au** // web ■ **acfonline.org.au**

The Australian Conservation Foundation is committed to achieve a healthy environment for all Australians. We work with the community, business and government to protect, restore and sustain our environment.

14 September 2005

Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility

The Australian Conservation Foundation (ACF) commends the Parliamentary Joint Committee for undertaking an inquiry into corporate responsibility, and welcomes the opportunity to make this submission to the inquiry.

The legal and practical drivers of corporate decision-making are key determinants of the sustainability of the Australian economy and thus our collective wellbeing. Until these drivers are aligned with the long-term interests of the Australian community, including the restoration to health of the Australian environment, our businesses will continue to leave a legacy of environmental and social harm.

To this end, the incentives and obligations of corporate managers, directors and shareholders must be examined as a complete system, and should be structured around the principle of ecologically sustainable development and, only subject to that overarching principle, market efficiency.

Following an introduction to the concept of corporate responsibility and the current practice in Australia, this submission outlines the following 11 reforms that would better induce Australian businesses to act responsibly and consistently with the long-term interests of the Australian community:

1. **Recovery of unjustified executive incentive compensation.** Where full financial provision for environmental and social liabilities is not made at the time the actions or omissions leading to such liabilities occur, a corporation should have the right and obligation to recover performance-based executive compensation awarded during the relevant period.

2. **Clarification of directors' duties.** A director's duty to act in the best interests of the corporation should explicitly entail an obligation to consider the interests of all

relevant constituencies, including the environment and communities in which the corporation operates.

3. **Expansion of trustees' duties.** Common law and statutory trustees' duties (including section 52 of the *Superannuation Industry Supervision Act 1993*) should provide that trustees of investment funds, in discharging their duties, must take into account environmental and social considerations.

4. **Safe harbour for corporate philanthropy.** The *Corporations Act* should provide for explicit recognition of the permissibility of reasonable corporate philanthropic activities, whether related to shareholder profits or not.

5. **Extension of liability for social and environmental harm.** Individuals and communities who suffer environmental damage, personal injury or death, or human rights violations should have recourse to holding companies for the acts of their subsidiaries, to successor entities in asset transfers, and to other parties with the ability to influence operational decisions who fail to take reasonable steps to avoid or limit such liabilities.

6. **Mandatory disclosure of social and environmental data.** Large corporations should be required to disclose key environmental and social data, including key CSR risks, to the public.

7. **Elimination of perverse subsidies.** Government subsidies that reward socially and/or environmentally harmful corporate behaviour should be dismantled.

8. **Creation of sustainability investment incentives.** The government should create positive tax incentives to leverage greater private sector investment in socially and/or environmentally positive projects.

9. **Revision of insolvency and winding-up laws.** Insolvency and winding-up laws should make full provision for long-tail liabilities, whether or not the identities of potential future creditors can be ascertained.

10. **Remedies for unethical overseas conduct.** Australian law should provide a legal remedy in Australian courts for any persons injured through a breach of the United Nations Human Rights Norms for Business.

11. **Promotion of institutional reform and capacity-building.** The government should improve the capacity of ASIC on corporate responsibility issues, create a National Corporate Responsibility Commissioner, improve government reporting and procurement policies, and adopt the Genuine Progress Indicator to replace GDP as the fundamental indicator of our success as a society.

Introduction

What is corporate responsibility?

Many people and groups contribute to the success of a business; each has a legitimate claim based on that contribution to enjoy in the fruits of that success.

Some contributions are direct, as when an employee contributes their labour, while others are more diffuse, as when a community provides a healthy environment and vibrant culture which enhances the ability of the business to retain happy, qualified staff and otherwise to be successful.

Some contributions are made through formal, contractual relationships, while others are delivered through non-negotiated, implicit relationships. For example, in allowing a company to operate, a community implicitly grants to the company the utilisation of some portion of that community's limited environmental carrying capacity – that is, the ability of the environment to supply resources such as clean water and air, to absorb and recycle limited quantities of waste, and to provide a stable climate. In return for the privilege of utilising that environmental carrying capacity, the community is entitled to expect that the business will do its part not to leave a degraded environment for future generations.

Corporate responsibility is therefore best understood as the reciprocal obligations that a business incurs because of the contractual or implicit contributions of all relevant groups to that business' operations and success.

The following table shows some of these groups and the salient features of their relationships to the business:

Group	Contributions	Relationship	Corporate obligations
Shareholders	- Financial capital - Assumption of top risk band - Ultimate management	Primarily legal (*Corps Act* and organisational documents); may also be contractual	Dividends and/or increase in capital value consistent with other obligations
Financial investors	- Financial capital - Assumption of risk - Expertise, sometimes	Primarily contractual	Repayment of interest and capital
Directors	- Management oversight	Legal and contractual	Compensation
Employees	- Intellectual and physical labour - Experience, initiative, commitment, continuity	Contractual (individual or collectively)	Fair compensation and conditions; respect for human rights; safety; employment security consistent with other obligations
Customers and end consumers	- Intermediate and ultimate demand for products and services	May be direct and contractual, or mediated through retailers; also subject to legal regulation	Duty of care; fair competition and trade practices

Suppliers	- business inputs	Primarily contractual	Payment for inputs; fair competition and trade practices
Local communities in which company operates	- local security - conducive business environment - social, cultural and environmental amenities - environmental carrying capacity (biodiversity, land, renewable and non-renewable resources, ecosystem services) - subsidies and other support - physical infrastructure	Primarily informal and implicit; some local regulation	Compliance with laws, taxation, responsible use of environmental carrying capacity and support for community
State / national communities in which company operates	As above, plus: - national security - regulation - licence to operate - assumption of residual risk in insolvency	Implicit in licence to operate; legal regulation	Compliance with laws, taxation, responsible use of environmental carrying capacity and support for community
Global community	- international trade - environmental carrying capacity (biodiversity, stable climate, etc)	Almost wholly implicit; mediated through national governments	Responsible use of greenhouse and other global environmental carrying capacity; fair trading conditions

Do organisational decision-makers have regard to non-shareholder interests?

At most Australian corporations, non-shareholder interests are considered only insofar as they contribute to increased shareholder value. Such interests have no independent value or consideration; they are deemed legitimate concerns of the corporation's Board and management if and only if they add to, or least do not detract from, shareholder profits.

Some corporations state this more or less openly. An example is Woolworths, which states in its "corporate governance manual" that:

> *The overall primary objective set by the Board is the enhancement of long term shareholder value. Directors have a duty to act in the best interests of the corporation as a whole, which means that they must act in the best interests of all members …*
>
> *Although directors have a duty to act in the best interests of the corporation's members, a corporation has a separate legal existence and operates in a social and economic context. Corporations have customers, suppliers and employees and carry on their business in a physical environment. Directors have general, and in some cases specific legal responsibilities, in relation to customers, creditors, employees and the environment.*
>
> *However, a board's paramount duty is to its members. Only when a corporation is insolvent or faces a risk of insolvency does the law expect the interests of another*

> *stakeholder eg creditor, to take precedence over the fundamental duty to members.*[15]

Notwithstanding the brief nod to other “responsibilities”, a director operating under this guidance will have no doubt about to whom ultimate allegiance is owed, or about how she is expected to act if the interests of the shareholders clash with “responsibilities” to other groups.

Woolworths’ position is typical; a review of the corporate governance guidance or annual reports of most of Australia’s top corporations will reveal statements similarly establishing a clear precedence of shareholder interests above all else.

In practice, there are numerous cases of Australian companies that have acted with gross disregard of the environment and the communities in which they operate. The following cases are a small sample of recent irresponsible corporate behaviour:

- Esmeralda’s disastrous cyanide spill in 2000 that killed off large stretches of three Eastern European rivers, including the Danube;

- ERA’s criminal poisoning of its own workers with uranium at its Ranger mine in Kakadu in 2004;

- The lawsuit by Gunns Limited against community activists for, among other things, voicing their concerns about Gunns’ unsustainable logging practices to Gunns’ investors and customers;

- Shell’s lengthy record of criminal pollution offences and breaches of its licence over many years at its Geelong refinery, including scores of oil spills into Corio Bay and 394 licence breaches during 2003-2004[16];

- The negotiation of contracts by companies that constrain the ability of governments to take responsible environmental action. One example is Transurban’s negotiation of an indemnity that effectively prevents Victoria from constructing a rail line from Melbourne to the Melbourne Airport, which would compete with Transurban’s more polluting road connection. Another example is UK-based International Power’s deed with the Government of Victoria that gives the Hazelwood power plant – the worst polluting plant in Australia and among the worst in the industrialised world – special rights to challenge any future regulation of greenhouse pollution or claim compensation if such regulation does not treat Hazelwood “equitably”.

[15] Woolworths Limited, “Corporate Governance Manual”, p. 8, available at http://www.woolworthslimited.com.au/shareholdercentre/corporategovernance/corporategovernancedocument.asp.

[16] See Ewin Hannan, “Shell faces fresh charges on oil spill risk”, *The Age*, 12 September 2005.

These are among the more egregious of recent corporate excesses, but there are other examples given throughout this submission and many others besides.

In each of the cases discussed, the inadequacy of government regulation and/or the difficulty of enforcing existing regulations, or in some cases sheer governmental incompetence, played a major part. Even in the case of criminal activity, as in the cases of ERA and Shell, the maximum penalties amounted to little more than a slap on the wrist for a large and profitable company.

It also apparent that none of the supposed controls on corporate malfeasance – enlightened shareholder value, corporate reputation, voluntary commitments, personal ethics – were sufficient to prevent these events.

To be sure, there are a growing number of Australian companies that take their obligations to the community seriously. Australian insurer IAG is a good example: for the past several years IAG has developed a comprehensive strategy to address global warming and has rolled out a highly innovative environmental management program for its smash repair contractors. Recycling companies such as Visy, renewable energy businesses such as Origin and Pacific Hydro, and investment companies such as Australian Ethical Investment have also been leaders, notwithstanding often unsupportive regulatory frameworks.

Nevertheless, serious problems abound. The following case studies examine in more detail two cases where the lack of effective penalties for irresponsible action and the skewed incentives of corporate decision-makers has led to serious community and environmental costs.

Case study 1: Abandoned contaminated mining sites

In 1994, the US-headquartered company Pegasus Mining opened a gold mine at Mt Todd in the Northern Territory. The project involved acid leach mining, a method that requires the use of hazardous chemicals on a large scale that was well-known at the time to have caused extensive groundwater and site contamination at other Pegasus sites.

Given its atrocious record in the US, Pegasus never should have been allowed to operate in Australia. It was, and the Mt Todd mine turned out to be a financial and environmental disaster. Mining by Pegasus Gold Australia ceased after only 3 years, with the company being placed under external administration in 1997. A consortium of Multiplex, General Gold Resources and Pegasus sought to recommence mining in 1999, but following a default by the other partners, Pegasus resumed full ownership in 2000. Attempts to sell the mine as a going concern failed, and Pegasus Gold Australia went into receivership.

The operations at the site, brief though they were, resulted in a toxic mess of immense dimensions. Pegasus had left behind on-site storage units containing nearly 800,000 tonnes of cyanide and other toxic chemicals, and a massive pile of rock waste leaching heavy metals and acidic water. The Northern Territory Minister for Mines and Energy has described it as a "disaster", with estimated total remediation costs of at least $20 million.[17]

The vast majority of these remediation costs are being picked up by Northern Territory taxpayers, since Pegasus posted a remediation bond of only $900,000. According to the Minister: "Mt Todd is not a pretty site. The fact is government should never have been put in the position of managing what is a private sector responsibility."

Similar environmental issues and declining gold prices drove Pegasus Gold Inc., the U.S. parent entity, bankrupt in 1998, leaving U.S. taxpayers stuck with tens of millions of dollars in environmental clean-up costs. Even as the company spiralled into bankruptcy, millions of dollars in bonuses were paid to top executives. Following restructuring, however, three of Pegasus' former mines were spun off as Apollo Gold, and continue to earn profits for shareholders to this day. None of the profits from those mines, of course, are available for remediation of contaminated sites either in the U.S. or Australia. In any event, because of the limited liability of the U.S. parent with respect to its Australian subsidiary, recovery from the U.S. parent company could not even have been contemplated unless a parent guarantee had been required as a condition for mining.

The case of Mt Todd is not unique. A 1999 report by CSIRO identified acid mine drainage undertaken at hundreds of mine sites around Australia, and highlighted that there were "many examples" of sites, active and abandoned, that "have not been managed environmentally and which have caused varying degrees of contamination."[18]

The Mt Todd case highlights that abandoned contaminated mines are not just a legacy of events long in the past. Mt Todd commenced operations a scant 12 years ago, in a period of full awareness of the risks of acid leach gold mining. Second, the case shows how corporate law encourages unacceptable risk-taking with the environment. The shareholder in the operator of the mine (ie, the U.S. parent company) was shielded from the actual clean up costs by the principle of limited liability and the structure of insolvency law, and thus had no incentive to manage the site responsibly.

Case study 2: derelict petrol station sites

In a 2001 submission to the fuel tax inquiry, the Victorian Automobile Chamber of Commerce (VACC) described the structures and processes that have led to the closure and abandonment of many petrol stations with no regard for environmental considerations or site rehabilitation. The factors contributing to the neglect of social and environmental considerations, in VACC's view, were as follows:

[17] See Northern Territory Hansard, 30 November 2004, available at http://notes.nt.gov.au/lant/hansard/hansard9.nsf/0/cc16938c8ae0aafe69256f7100194889.

[18] CSIRO, "CSIRO Tackles Ecological Time Bomb", 6 January 1999, available at http://www.csiro.gov.au/index.asp?type=mediaRelease&id=CsiroTacklesEcologicalTimeBomb&style=mediaRelease.

> *As these businesses fail and the service stations close, simply "selling off" and walking away is not an option - unlike merchandise traders. Service station sites have, in many cases, become an environmental liability. The low value of land in rural areas and the projected costs involved in cleaning up potential soil and groundwater contamination have caused some sites to be simply abandoned.*
>
> *Site clean-up and removal of underground fuel storage tanks is often not considered because of the following:*
>
> > *a) Environmental issues, such as potential contamination, are not always immediately apparent.*
> >
> > *b) Even if the operator was aware of issues of tank leakage, fuel monitoring and environmental requirements, such things faded into the background as all their endeavour focussed on survival. The lack of income and any structural adjustment assistance, makes it impossible for them to do anything about it.*
> >
> > *c) The desperate hope of selling the site as a going concern. Therefore, the equipment is retained so that another person may be able to "make a go of it".*
> >
> > *d) Cost of tank removal and site clean-up is beyond the capabilities of the service station operators/owners to pay. However, many are orphaned sites. The owner who closed the site is either not available or not contactable. Some have even died.*
> >
> > *e) Many simply walk away from the business and lose everything - including their "superannuation" which is or was, the now non-existent or even negative value of the business and property.*
>
> *Consequently, fences are erected around the perimeters of orphan sites, leaving behind a legacy of negativity and destitution. Many orphaned sites are described as "eye-sores" of the townships. Beyond being a major environmental and economical issue, this has become a major Local Government issue in regional areas. The closure of many service stations has had a major negative impact on the towns' morale.*[19]

Underlying these developments is the fact that many petrol stations are operated as franchises. A franchise structure enables large petroleum companies to extract profits from

[19] Victoria Automobile Chamber of Commerce, “Submission to the Fuel Tax Inquiry” 22 October 2001, available at http://fueltaxinquiry.treasury.gov.au/content/Submissions/Industry/downloads/VACC_239.pdf.

individual sites through franchise fees, while evading all of the liabilities that direct ownership would entail, such as site remediation. Franchises are an immensely successful business model precisely because of the ability of the franchisor to push liabilities onto individual operations, from which they are insulated, without sacrificing profits. The owners of individual sites have neither the ability nor the resources to remediate a failed site, while the franchisor has no incentive or legal requirement to do so.

How can reforms to the legal framework encourage organisational decision-makers to have regard to interests other than shareholders?

This question is taken up in the bulk of this submission. However, it is important to view possible reforms in the context of the organisational decision-making process as a system. This system includes at least three distinct but inter-related levels of corporate decision-making: the shareholders, the Board, and management.

Attempts to inculcate greater corporate responsibility must address this system in a holistic way, cognisant of both legal and non-legal considerations that drive corporate decisions. An isolated change to one aspect of decision-making, such as director's duties, may have very little effect if other, overriding factors (such as shareholder and Board control over incentive-based executive compensation) clash with that change.

Direct legal duties are important, but are by no means the only or even the most important drivers of corporate decision-making. The major incentives operating on each group of decision-makers are as follows:

Management: Managers have basic legal duties towards the corporation, and duties to comply with other generally applicable laws. The force of these will depend on who has the ability to enforce the obligations, what capacity and will they have to engage in enforcement action, and what personal and/or corporate penalties attach to a breach. The structure of executive compensation packages, especially the performance targets that the Board sets for senior executives, is another major influence. By setting performance incentives that reward executives for maximising shareholder value, the Board and the shareholders create a personal financial interest for management to pay greater attention to shareholder interests than to other interests. Board and shareholder control over executive appointments, and their ultimate ability to override executive decisions, also shape how an executive will manage a corporation.

The Board: Directors of a corporation are under specific duties to the corporation, as set out in the *Corporations Act*, and have other legal duties as well. Again, the effect of these depends on enforcement mechanisms and penalties. In addition to those, the directors are ultimately accountable to the shareholders. The mechanisms of shareholder control include power over appointments and compensation, and the ability to override specific decisions by shareholder resolution.

Shareholders: For individual shareholders, the desire to earn financial returns is a major driver of behaviour. A shareholder's decision-making is also coloured by the existence of limited liability for the debts of the corporation, and any possibility of piercing the corporate veil. Personal ethics of the shareholder and transactional and agency costs are further influences.

For institutional shareholders, the decision-making calculus is more complicated. Such shareholders are frequently under legal duties of their own, such as trustee's duties under common law or statute (particularly the *Superannuation Industry (Supervision) Act 1993*). Institutional shareholders will also operate under their own personal and organisational incentive structure, and may be motivated to increase the number of their customers or members. The expressed desires of an underlying constituency may be important (as in a managed fund with few investors), or may be disregarded (as in a superannuation fund with a statutory portfolio maximisation duty).

When the shareholder is a holding corporation controlling a subsidiary, any possibility of the parent company becoming liable for the debts of the subsidiary (through veil piercing, or parent-level guarantees) is among the very few constraints on profit-maximising behaviour.

The reforms outlined in section 1 of this submission are aimed at improving management decision-making. Section 2 is concerned with Board decision-making, while sections 3 and 9 are concerned primarily with shareholder decision-making. Section 5 has aspects that pertain to each group. The proposals in the remaining sections tend to act on corporate profitability overall, and so may influence the decision-making of all three groups.

These reforms should be viewed as an interrelated package. For example, adoption of reforms to directors' duties, without any change to the incentives under which shareholders operate and the structures of financial compensation that encourage managers to increase share prices, will do little to shift corporate decision-making in any meaningful way.

1. Recovery of unjustified executive incentive compensation

Executive compensation packages strongly discourage management consideration of long-term corporate, community and environmental issues.

The clearest expression of a company's priorities is how it chooses to reward its senior management. A company that adopts compensation packages for its managers that reward only short-term financial performance sends a very clear message about what it expects them to do. Managers that operate under such contracts will correctly perceive that exhortations by the Board or shareholders to "think long-term" or "have regard to a broad range of stakeholders" are peripheral and unimportant, or even just public relations drivel.

In practice, performance-based executive compensation at most top Australian companies is awarded exclusively or primarily on the basis of such short-term financial performance indicators. Executive compensation is typically a mix of fixed compensation, short-term incentives and so-called “long-term” incentives. Short-term incentives are based on annual performance measures, and may include financial and non-financial criteria. “Long-term” incentives are typically share options that vest within 3-5 years from the time of grant if performance hurdles (almost always some indicator of share performance) are satisfied.

There are scattered examples of more creative, long-term performance incentives. A few companies, generally in the resources sector, base some component of short-term incentives on the attainment of non-financial environmental and social performance goals that contribute to the long-term success of the organisation. BHP Billiton, for example, has Group KPIs in the areas of health, safety and environment that affect annual cash bonuses of senior management up to and including the CEO level. Such non-financial KPIs tend to be a very small part of total at risk remuneration, however, and are in any case the exception rather than the rule.

Thus, despite some modest improvements at a few companies, most executives have an overwhelming financial disincentive to look beyond a 3-5 year time horizon. If an executive takes steps to reduce long-term environmental and health risks, to invest in innovation with long lead times, or to position the company to succeed under likely medium-term regulatory and environmental changes, she most likely does so in spite of her own financial best interests, and not because of them.

This is not to say that executives will always act irresponsibly, with an exclusive focus on short-term profit maximisation. However, it is unreasonable to think that most executives will consistently devote meaningful attention to long-term environmental and community concerns given the incentives under which they operate.

A solution: recovery of incentive compensation to cover environmental and social liabilities.

Performance-based executive compensation should be subject to recovery by the company if the company incurs additional environmental or social liabilities (1) as a result of corporate actions or omissions taken during the period for which such compensation was awarded; and (2) for which full financial provisions were not made during that period.

This rule would create a clear financial incentive for executives to take into account long-term environmental and social risks without any legislative interference in the actual negotiation of executive compensation packages.

The possibility of compensation recovery would strongly encourage decision-makers to take a precautionary approach to possible or certain long-tail liabilities and to insist that they are fully assessed and costed in the corporate decision-making process. Faced with the potential loss of incentive compensation, executives will be inclined to err on the side of over-provisioning for such liabilities rather than under-provisioning. This may, in turn, reduce the incidence of orphaned contaminated sites, for example, or under-funded personal injury compensation funds.

Overseas model: United States
Incentive executive compensation recovery

In 2002, the U.S. adopted a clawback of incentive executive compensation where a company has to restate financial reports. According to section 305 of the Sarbanes-Oxley Act, if an issuer of publicly-traded securities has to prepare a restatement due to “material non-compliance” with financial reporting requirements, the CEO and CFO must “reimburse the issuer for any bonus or other incentive-based or equity-based compensation received” and “any profits realized from the sale of securities of the issuer” during the period covered by the restatement.

While the U.S. scheme is based on financial reporting non-compliance rather than environmental and social liabilities, it provides a workable and tested model for encouraging decision-makers to have regard to long-term community and environmental interests.

Of course, full recovery may not be practical in all cases. By the time subsequent liabilities become evident, years or decades may have passed and the culpable executives may no longer have sufficient funds to reimburse the company, or may even be deceased. In addition, some companies may be reluctant to exercise their rights under the clawback for a variety of reasons, including personal ties and a desire that compensation recovery would discourage qualified executives from serving with the company in the future.

To address these difficulties, companies should be required to exercise their rights under the recovery provision, unless they obtain a waiver from ASIC, which can be granted only if there is no reasonable prospect of a significant recovery of funds.

2. Clarification of directors’ duties

Australian directors’ duties are generally interpreted to prohibit consideration of non-shareholder interests where they do not contribute to shareholder value.

The duties set out in sections 180 and 181 of the *Corporations Act* are almost universally interpreted as require directors to maximise financial returns for the shareholders of the corporation. Thus, a corporate partner of a major Australian law firm recently observed that:

> The traditional view under the *Corporations Act* and at common law is that a director’s duty to act in the best interests of the corporation requires a director to govern solely in the interests of shareholders by maximising profits. Directors are

> not required to consider social or environmental issues in the discharge of their duty.[20]

That this is the standard interpretation can hardly be questioned. To be sure, the directors' obligation in section 181(1)(a) is to act in the best interests of the "corporation", not in the best interests of the "shareholders". However, in the minds of many, these amount to one and the same thing – or, to be more precise, the "corporation" is little more than a piece of property owned by and operated ultimately for the sole benefit of the shareholders. Thus, Woolworths instructs its directors that the duty to act in the best interests of the corporation means a duty to act in the best interests of Woolworths' members, as a priority overriding any other corporate constituencies.[21]

This interpretation does not discourage consideration of non-shareholder interests – it positively prohibits it, except insofar as those interests might be a useful tool for increasing shareholder profits.

This view has not gone unchallenged. There are alternative views of what a "corporation" is. One such view is that the corporation is not a piece of property, but a nexus of contractual and non-contractual relationships between and among a range of groups, of which the shareholders are but one. To act in the best interests of the "corporation", so conceived, would mean to act in the collective welfare of all participants in this web of relationships.

ACF and others have urged an expansive interpretation of the duties in section 181, so that the obligation to act in the best interests of the corporation is understood as empowering directors to take into account the environment and a more balanced range of corporate constituencies.[22] Furthermore, the various cases establishing the duty to creditors, at least when a company is nearing insolvency, established beyond a doubt that the company's best interests can diverge from those of the shareholders.

However, it is not enough to point to the fact that the words of the statute are capable of bearing a broader interpretation than mere devotion to shareholder profit maximisation. The fact remains that view has not attained widespread currency, and the traditional view that shareholders are the only or at least the primary corporate constituency still prevails overwhelmingly.

The traditional interpretation, however misguided and narrow, inhibits organisational decision-makers from considering interests beyond the financial interests of the shareholders. Nowhere was this more clear than in the James Hardie controversy. One of

[20] Mark Standen, "Corporate social responsibility: the Jackson Inquiry and tsunami donations", *Company Secretary*, July 2005, page 332, available at http://www.minterellison.com/public/resources/file/eb3e214cd56848a/CorporateSocialResponsibility.pdf.

[21] See note 1, above.

[22] See, for example, C Berger, "The Myth of Shareholder Primacy", *Online Opinion*, 13 May 2005, available at http://www.onlineopinion.com.au/view.asp?article=3436.

the very few things upon which James Hardie Chair Meredith Hellicar and ACTU Secretary Greg Combet agreed during the fight to obtain full compensation for the victims of asbestos was that the Australian directors' duties inhibited James Hardies' Board from topping up the compensation fund because of a fear of shareholder lawsuits, and that these duties need to be expanded to encompass other corporate constituencies.[23] Indeed, Ms Hellicar compares Australian law unfavourably to Dutch law, where consideration of the relationships among the company and all those involved in its organisation is permissible.

The James Hardie case highlighted the irreconcilability of the usual view of directors' duties and obligations to other corporate constituencies, but it is by no means a unique case. To a greater or lesser extent, those same duties underlie all of the instances of corporate malfeasance discussed in this submission.

The Corporations Act should clarify that the duty of a director to act in the best interests of the corporation entails an obligation to consider all corporate constituencies.

The *Corporations Act* should make explicit what is already the best reading of the text of section 181: that the obligation to act in the best interests of the corporation means a director should consider the interests of all corporate constituencies.

The best way of doing this would be to specify a non-exclusive list of relevant constituencies. Such a list should specifically include employees, financial investors, shareholders, customers and suppliers, communities in which the corporation operates, and the environment.

This development would not constitute a radical change to Australian corporate law, but would clarify that companies that wish to take into account the interests of the community and the environment may do so without fear of shareholder lawsuits. Seen in this light, the reform is much more about deregulating directors' duties and removing a barrier to responsible decision-making than about imposing a new burden.

There are a number of common objections to this and similar proposals for reform. The main objections and a response are as follows:

- *By making the directors accountable to all, they will be accountable to none.* This objection ignores the existence of direct control mechanisms by the shareholders, including the shareholders ultimate control over board appointments and compensation, the ability to pass binding shareholder resolutions, and the power to define and amend the organisational

[23] See Bill Pheasant, "Directors need a safe harbour: Hellicar", Australian Financial Review 17 March 2005, p.3; and Greg Combet, Speech to ACSI Corporate Governance Conference, 9 July 2005, available at http://www.actu.asn.au/super/news/1121040235_1934.html.

documents under which the corporation acts. A broadening of directors' duties will not dismantle these more important control mechanisms; it would simply remove a directors' fear that he or she could be personally sued for protecting the environment, giving to charity, paying a fair wage or refusing to engage in legal but harmful business activities.

- *Directors will not be able to balance competing interests.* Businesspeople and other professionals are constantly balancing competing interests. Directors already have to balance the interests of shareholders seeking short-term gains versus those with a longer investment horizon; they also must engage in a very delicate balancing of shareholder and creditor interests when a company approaches insolvency. Furthermore, they routinely must balance the competing internal demands of various business areas for scarce resources. They do not appear to be unable to accomplish any of this – indeed, it is at the core of their role as managers. Lawyers have obligations to their client and obligations to the Court; politicians must balance the competing interests of a vast range of societal constituencies. There is no reason to think businesspeople are unable to negotiate similarly complex duties.

- *Broadening directors' duties will expose companies to frivolous lawsuits from community activists.* Currently, a director's duty is to the company, and it is the company that has primary responsibility for taking action if the duty is breached. Shareholders have a limited right to take action on the company's behalf. With no modification of these standing rules, an clarification of directors' duties would tend to limit shareholder suits rather than enable suits by non-shareholders. Furthermore, the existence of the business judgment rule in section 180(2) would, as before, insulate most business decision-making from review. Finally, the Australian rule that the losing party pays the other side's costs in most litigation is a very effective deterrent against frivolous lawsuits even under broad standing regimes.

- *Expanding directors' duties will discourage investment and erode economic performance*. Again, there is no evidence of this in other jurisdictions that have adopted, or that have always had, more inclusive views of what a corporations' interests are. The real threat to a sound economy is from unsustainable economic practices, not from any imagined decrease in incentives that corporate responsibility would cause. Unsustainable businesses impose costs on the community in the form of contaminated sites, degradation of natural resources, pollution and its health effects, generation of waste and similar injuries. These costs force investment into unproductive activities (such as remediation, health care, waste disposal, etc) and impair the health of the economy overall.

Many foreign jurisdictions have broader definitions of directors' duties.

Following is a brief review of the legal position of directors in other modern economies.

- *Canada.* In Canada there is clear judicial acceptance that a directors' duty to the corporation permits consideration of non-shareholder interests, whether they promote shareholder value or not. For some time the sole authority for this was a lone 1973 case from the Supreme Court of British Columbia, but the proposition has been affirmed in other recent cases.[24]

  This was placed beyond question in 2004, when the Supreme Court of Canada in *Peoples Department Stores v. Wise* accepted "as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[25]

- *Civil law systems.* It is important to realise that the concept of shareholder primacy is foreign to the half of the world that operates under a civil law model. In Germany, for example, a director must promote the *Unternehmensinteresse*, or "interests of the company", which is a concept clearly distinct from the interests of the shareholders. A prominent German corporate law expert summarises the concept as follows:

  The content of the company's interests is 'the upholding and ongoing functional fulfilment of the company's duties to investors, workers, suppliers, customers, consumers, state and society'. The company's interests take into account both substantive and procedural aspects. The realisation of the company's interests involves, for example, the Board's approach to weighing up the coinciding and/or conflicting interests of stakeholders and resolving them through the principle of "practical concordance". It follows, in particular, that the Board is not obligated to pursue the exclusive goal of profit maximisation; to the contrary, the prevailing opinion admits a greater scope of discretion in incorporating the interests of other groups.[26]

  Indeed, it is uncontroversial that a German company director can, for example, make provisions for employees even if there is clearly no benefit for the

[24] *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C.); *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Div. Ct.);

[25] *Peoples Department Stores Inc. (Trustee of) v. Wise*, (2004), 244 D.L.R. (4th) 564.

[26] Chritoph Kuhner, "Unternehmensinteresse vs. Shareholder Value als Leitmaxime kapitalmarktorientierter Aktiengesellschaften" (Company Interest vs. Shareholder Value as central principle of capital market-oriented corporations), Presentation to Instituts für Arbeits- und Wirtschaftsrecht der Universität zu Köln, 21 July 2003, available at http://www.econbiz.de/archiv/k/uk/swpruefung/unternehmensinteresse_shareholder_value.pdf. (Citations omitted; translation by author of this submission.)

shareholders because, for example, the company is about to cease trading as a result of a merger.[27]

- *United Kingdom.* In the U.K., section 309 of the *Companies Act 1985* obliges directors to have regard to the interests of the company's employees as well as its members in the performance of their duties. In addition, the government has released a draft Company Law Reform Bill, which largely reflects an "enlightened shareholder value" theory of directors' duties. It would retain a primary obligation to act for the benefit of the company's members, but specify that in doing so directors should have regard to "any need of the company" to consider the interests of its employees, the environment, the community, and so forth.

  The difficulty with this bill is that it treats the interests of corporate constituencies as means to the end of shareholder profits, rather than legitimate interests in themselves. In effect, the bill provides no greater consideration for communities or the environment, and no safe harbour for directors, beyond that contained in a simple unadorned statement of shareholder profit maximisation. For this reason, it has been opposed by many workers' groups, because it downgrades the interests of employees from an independent consideration on par with members to a mere instrument for achieving shareholder profits.

- *United States*. In the U.S., there is some diversity in approach among the 50 states. Historically, there was little consensus among courts as to whether the interests of non-shareholders could legitimately be considered by directors. To a large degree, the difference between shareholder primacy and other points of view was mostly of academic interest; as far as courts were concerned, the business judgment rule insulated most operational decisions from review. As one academic put it:

  In most jurisdictions, courts will exhort directors to use their best efforts to maximize shareholder wealth. In a few jurisdictions, courts may exhort directors to consider the corporation's social responsibility. In either case, however, the announced principle is no more than an exhortation. The court may hold forth on the primacy of shareholder interests, or may hold forth on the importance of socially responsible conduct, but ultimately it does not matter. Under either approach, directors who consider nonshareholder interests in making corporate decisions, like directors who do not, will be insulated from liability by the business judgment rule.[28]

  However, following the wave of hostile takeovers and plant closures in the 1980s,

[27] Theodor Baums, "Personal Liabilities of Company Directors in German Law", Arbeitspapier 35, available at http://www.jura.uni-frankfurt.de/ifawz1/baums/Arbeitspapiere.html.

[28] Stephen Bainbridge, *Interpreting Nonshareholder Constituency Statutes,* 19 Pepperdine Law Review 971, 979-980 (1992).

at least 31 of the 50 states enacted “corporate constituency” statutes overriding traditional notions of shareholder primacy. These statutes are diverse, with some limited to the takeover context and others extending to all corporate decision-making. Most of these statutes are permissive, in that they allow but do not require directors to consider non-shareholder interests. However, the statutes of Connecticut and Arizona are both mandatory, though limited to the takeover context. Statutes in Pennsylvania and Indiana explicitly reject the primacy of shareholder interests over those of other constituencies.

An example of a relatively broad constituency statute is that of Vermont:[29]

§ 8.30. General standards for directors

(a) A director shall discharge his or her duties as a director, including the director's duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner the director reasonably believes to be in the best interests of the corporation. In determining what the director reasonably believes to be in the best interests of the corporation, a director of a corporation … may, in addition, consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations, including those of any community in which any offices or facilities of the corporation are located, and any other factors the director in his or her discretion reasonably considers appropriate in determining what he or she reasonably believes to be in the best interests of the corporation, and the long-term and short-term interests of the corporation and its stockholders, and including the possibility that these interests may be best served by the continued independence of the corporation; ….

It may be that these statutes have not had a great impact on most corporate decision-making, though it is reasonable to think that they make it easier for ethically-minded directors to take community and other considerations openly into account. The limited impact is attributable to a combination of (1) the permissive rather than mandatory nature of nearly all of them; (2) the lack of standing by non-shareholders to enforce them; and (3) the lack of any broader structural and legal reforms, such as those outlined in this submission, to address the remaining bulk of corporate incentives to ignore non-shareholder interests.

[29] Vermont Statutes Annotated, Title 11A, section 8.30.

> In states that have not adopted a corporate constituency statute, the legal duties of a director remain defined substantially by the courts. In Delaware, the state of incorporation of around 50% of publicly-traded U.S. corporations, judicial precedent has made clear that maximisation of shareholder profits is not required, even in the takeover context. This is demonstrated by the case of *Paramount Communications, Inc. v. Time Inc.*[30] In that matter, the Board of Time, Inc., refused to put to a shareholder vote a tender offer by Paramount Communications, notwithstanding a substantial premium for the shareholders. Instead, the Board supported a merger with Warner Brothers, which was by all accounts less advantageous to the financial interests of Time's shareholders. Part of the directors' justification for rejecting the Paramount bid was their view that it presented a threat to the "Time Culture" and the notions of "journalistic integrity" that included. The Court upheld the Board's decision, holding that the directors were entitled to make judgments based on their long-term vision of the *corporation's* interest, apparently even though that entailed a clear sacrifice of short-term shareholder value. Many have argued that *Time* at least implicitly allows broad consideration of non-shareholder interests.[31]

3. Expansion of trustees' duties

Existing trustees' duties compel irrational and unethical investment decision-making.

However narrow the duties of directors are or are perceived to be, the duties of trustees are narrower still. Under section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993*, for example, a superannuation trustee must "ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries." The "best interests of the beneficiaries" in this context is most often interpreted as requiring trustees to maximise the financial return of the funds under administration. There is no option to opt-out of this provision; it must appear in the trust deed.

There are several difficulties with this rule. To begin with, maximising the return on the investment portfolio of the trust can in some circumstances actually be against the interests of the beneficiaries, or even against their net financial interests.

Consider, for example, the case of a large group of individuals who have been seriously injured by a defective product. They have legal claims against the manufacturer. In addition, their superannuation fund may hold shares in the manufacturer. It is clearly in the financial interests that the claims be paid out, since the value of those claims would be greater than any marginal change in the stock price of the manufacturer on their highly

[30] 571 A.2d 1140 (Del.1989).
[31] See, e.g., Lyman Johnson & David Millon, "The Case Beyond Time", 45 Business Law 2105 (1990).

diversified superannuation portfolio. Yet their own superannuation fund, if limited to maximising the value of the investment in the manufacturer, may feel compelled to support the manufacturer's efforts to resist those claims. If the matter should ever come to a shareholder vote, the superannuation fund could even feel compelled to vote against payout of claims, notwithstanding the suffering this could inflict on its own members.

Indeed, this was precisely the situation faced by some victims of James Hardie's asbestos products. Imagine the mesothelioma sufferer, faced with the prospect of being denied compensation in part as the result of his own superannuation fund applying pressure as a James Hardie shareholder to refuse to top up the compensation fund.

More fundamentally, many investors do not want their savings invested to maximise profits, no matter what the cost to the environment or community. ACF regularly hears from its members who are angered and frustrated to find that their retirement funds are used to finance unethical corporations. This has to be seen in the context of a system that mandates superannuation contributions and does not afford all workers choice of superannuation fund, particularly government employees and employees covered by a certified agreement.

Overseas model: Connecticut
Social and environmental considerations in investment policy

Connecticut state law explicitly recognises that social and environmental considerations are important in securing long-term economic benefits for beneficiaries of the state pension funds. In particular, section 3-13d(a) of the Connecticut General Statutes provides that

…Among the factors to be considered by the Treasurer with respect to all securities may be the social, economic and environmental implications of investments of trust funds in particular securities or types of securities.

In implementing this provision, the Investment Policy Statement for Connecticut's Retirement Plans and Trust Funds states (p.21) that:

… Prudence and consideration of corporate citizenship are complimentary goals, as recognized by State law. Primary among considerations for the investment of the pension plans and trusts, is the prudent investment of these assets for the long-term economic benefit of the plan participants and beneficiaries. Prudence includes considerations of performance, risk and return. In addition to prudence, State law states that the Treasurer may consider the social, economic, and environmental implications of its investments ….

We can not put it more eloquently that our member who wrote the following to us, upon discovering that his superannuation fund invests in unethical logging company Gunns Limited:

> *I found to my dismay that the CSS does invest in Gunns. As this scheme is compulsory for Commonwealth employees, and provides no option for member choice of investments, there is essentially nothing that I can do about it. Even the token action of contributing at the minimum rate, 5%, would make no difference to Gunns.*

> *The assistant secretary of the CSS, whom I contacted, says that the CSS is bound by prudential regulation and that dispensing with their investment with Gunns would require approval from the minister, which seems unlikely.*
>
> *It seems to me that a system that prevents people from exercising their social conscience, in fact forces them to invest in activities that they are ideologically opposed to, is a system that is out of control.*

Even for funds whose members and trustees are all agreed that they do not wish to invest in an unethical business, no matter what the returns, a decision not to so invest apparently entails legal risk for the trustees. At least as late as July 2002, law firm Allens Arthur Robinson was advising that selecting investments on the basis of environmental or social considerations could "threaten to contravene the fiduciary duties of a trustee not to fetter his or her discretion and to maximise the financial return on investments."[32]

These duties are a concern not only in the selection of investments. Inevitably, a trustees' decision on how to engage with a company and how to vote on resolutions will be coloured by the trustees' legal duties. Trustees that feel obligated to maximise returns, no matter what the social or environmental cost, will exert heavy pressure on the companies in which they invests to do the same. By the same token, they will accord little or no recognition to companies that act responsibly, unless those actions also happen to generate large shareholder returns.

In the broadest sense, even aside from investors that have a conscience, a rule that obligates trustees to maximise financial returns is a bad idea from the perspective of society as a whole for the exact same reasons that a rule that company directors should only maximise shareholder profits is a bad idea. If we do not want companies only to maximise profits, but rather to act responsibly and with reasonable regard to all constituencies, than we must conform not only the incentives of directors and executives, but also the obligations and incentives of shareholders as the ultimate controllers of corporate activity.

Trustees, in discharging their duties to their beneficiaries, should be obligated to take into account the interests of the community and the environment.

In any conflict between the desire and ability of corporate boards to take into account non-shareholder constituencies, and the desire of shareholders to have them decline to do so, the shareholders will prevail. Whether through direct means such as shareholder resolutions or removal of overly ethical directors, or more subtle means such as the setting of performance hurdles in remuneration packages, the shareholders can impose their will on the other organisational decision-makers.

[32] Julian Donnan, "Disclosure of ethical investment considerations", *In the Money*, July 2002, p 30, available at http://www.aar.com.au/pubs/itm/jul02/index.htm.

Therefore, if Boards are to be encouraged or required to consider non-shareholder interests, the incentives and obligations of institutional investors must be fully aligned to that end.

Accordingly, Commonwealth legislation (including section 52 of the *Superannuation Industry (Supervision) Act 1993*) should require trustees to take into account in the discharge of their duties the interests of the community generally and the environment. It is within these constraints that they should maximise financial returns for their beneficiaries. The practice in the State of Connecticut, where such considerations already supplement traditional notions of prudence in the management of the state's pension funds (see inset), is a practical demonstration of the viability of this model.

A variety of other legislation, including the various state Trustee Acts, would have to accompany these changes to set uniform considerations for how funds under management for the benefit of others should be invested. Following amendment of relevant Commonwealth legislation, the issue of trustees' duties under state law should be taken up through COAG.

4. Safe harbour for corporate philanthropy

The capacity of corporations to engage in philanthropic activities should be placed beyond question.

Following the Asian tsunami, the Australian Shareholders' Association suggested that some corporate donations to assist the victims of the disaster were impermissible. According to ASA spokesperson Stephen Matthews, "Boards of directors don't have a mandate from their shareholders to spend the money in that way and they have no way of possibly knowing whether or not their shareholders want their money – the shareholders' money – spent in this way."[33] In his view, donations were acceptable only if there is a financial benefit for the shareholders.

While the ASA subsequently issued a clarification specifying that it did not oppose donations provided shareholders were "kept informed", the uncertainty engendered by its comments remains. Further, the ASA's stance appears to have been a tactical retreat in the face of public outrage rather than a principled acceptance of corporate philanthropy. The ASA's chief executive subsequently stated that the tsunami was just a poor time to "put forward a considered point of view," which implies ongoing support for Mr Matthews' comments. In any event, the damage was done, and some commentators continue to

[33] ABC local radio, "Shareholders Association opposes corporate aid donation", 7 January 2005, transcript available at http://www.abc.net.au/am/content/2005/s1278328.htm.

suggest that “genuinely selfless” corporate philanthropy could be a breach of a directors’ duty.[34]

The view that corporate philanthropy is acceptable only if tied to shareholder value is inconsistent with community values, as evidenced by the backlash against the ASA’s comments. No less a public figure than Prime Minister John Howard urged corporate giving following the Tsunami; his plea for generosity was not limited to situations where donations would drive increased profits. The *Corporations Act* should reflect these views by explicitly recognising the acceptability of corporate donations, whether related to shareholder value or not.

The notion that corporate philanthropy must be linked to shareholder value is not only out of touch with community norms, but also completely unnecessary to protect shareholder interests. Shareholders already possess the ability to appoint (and dismiss) directors, set executive remuneration, and override any policies with which they disagree by shareholder resolution. If shareholders desire restrictions, disclosure, or a corporate donations policy of any sort, there is nothing preventing them from passing a resolution to that effect.

Overseas model: United States
Corporate philanthropy statutes

In the U.S., all 50 states have for many years had statutes explicitly permitting corporate philanthropic donations. 24 states authorise donations “donations for the public welfare or for charitable, scientific, or educational purposes”, a further 19 have similar provisions and authorise in addition donations “furthering the business and affairs of the corporation.”

Seven states, including New York and California, explicitly allow donations regardless of corporate benefit. New York’s Business Corporation Law, section 202(a)(12), sets out a replaceable rule that a corporation has the power:

> to make donations, irrespective of corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes, and in time of war or other national emergency in aid thereof.

Many of these laws were enacted to override the 19th-century view that corporate donations were *ultra vires*, or beyond the powers of a corporation.

Given these mechanisms of control outside of fiduciary duties, it seems unlikely that directors or executives would irresponsibly fritter away corporate assets if corporate philanthropy was explicitly shielded from review. This is backed up by evidence from the United States, where all 50 states explicitly permit corporate donations (see box). Despite such facilitative laws, the average corporate giving rate in the U.S. remains at a modest 1.0-1.3% of income, well below the average individual giving rate of about 1.9-2.2% despite the tax advantages of corporate over individual giving.[35]

[34] See Malcolm Maiden, “Tsunami: the backlash”, *The Age*, 12 February 2005, available at http://www.theage.com.au/articles/2005/02/11/1108061871800.html.

[35] See Einer Elhauge, *Sacrificing Corporate Profits In The Public Interest*, presentation at Environmental Protection and the Social Responsibility of Firms seminar, Harvard University, at p. 66, available at http://www.ksg.harvard.edu/cbg/Events/Papers/RPP_2-12-04_Elhauge.pdf.

For comparison, Australia's rate of corporate giving is running at an average of only 0.15% of corporate income.[36] Removal of any doubts about the legality of such initiatives is a precondition to encouraging Australia's corporate sector to improve upon this rate.

5. Extension of liability for social and environmental harm

The justifications for limited liability, while appropriate for negotiated commercial relationships, do not extend to shifting of environmental and social risks and liabilities to the community.

The point of forming a corporation is for individual shareholders to avoid personal liability for the corporation's debts. The cap on liability at the extent of a shareholder's investment in a corporation is commonly justified as necessary to facilitate risk-taking ventures, which are said to be the engine of economic growth.

It would be a curious feature of corporate law if it sought to encourage risk-taking, the very thing that so much of the rest of our legal landscape is concerned with discouraging. Indeed, the primary purpose of the law of unintentional torts, and much of the statutory law of products liability, trade practices, environmental law, and OH&S law is fundamentally designed to shift conduct so that it is less risky towards others and the community more generally.

Why, then, would we want to encourage the taking of risks by corporations that we affirmatively try to discourage individuals and non-corporate businesses from taking? It is not enough merely to say that risk-taking is necessary to stimulate economic growth: if so, why don't we exempt corporations from negligence laws altogether? Or, why not extend limited liability for business operations undertaken by sole proprietors? Surely either of these would stimulate even more risky behaviour, if that is the goal.

In fact, the principle of limited liability has nothing to do with encouraging or discouraging risk-taking. Rather, the point of limited liability is to provide a convenient and efficient baseline for the negotiation of shared entrepreneurial risks.

Financial investors are free to contract around limited liability, or course. A bank may, for example, require a businessperson to post his home as security for a business operation that, standing alone, would be too risky for the bank. Equally, a large supplier may require a parent-level guarantee as a condition of doing business with a subsidiary of a major corporation, if the subsidiary has few assets of its own.

[36] Prime Minister's Community Business Partnership, "Giving Australia: Summary of Key Data" (September 2004) at p. 31, available at http://www.partnerships.gov.au/philanthropy/philanthropy_research_ProjectUpdate.shtml.

Conversely, businesses that are not corporations may establish at least partial limited liability by contract. For example, a bank may provide a limited recourse loan to a partnership or sole proprietorship, under which the partners or sole proprietor is not personally liable except to the extent of specifically identified assets.

The rule of limited liability for corporations merely establishes a default position that facilitates an optimal degree of entrepreneurial risk-sharing in many cases among businesses and investors. Entrepreneurial risk in this sense encompasses the risk of business failure because of market factors such as competition, insufficient demand, or inability to keep pace with innovation.

This justification for limited liability makes sense if and only if entrepreneurial risks are transferred from businesspersons to other parties who have the capacity to negotiate with the corporation and who are themselves taking a calculated risk in doing business with the corporation. For example, a bank extending credit to a corporation knows that there is a risk of default, and is able to inform itself about that risk and reflect it in negotiating the terms of the loan. No injustice can be said to be done if the corporation, despite its good faith efforts, defaults.

Unfortunately, limited liability as it currently operates also distorts behaviour regarding environmental and social risks and embeds incentives for corporations to take less care in those areas than individuals would. The principle is not justified when applied to these situations, because the involuntary creditors that assume environmental and social risks have no capacity to negotiate for some of the benefits of such risk-sharing – or to decline the relationship if they find it not to their liking.

Consider, for example, a mining company that is deciding on the best level of environmental safeguards at its mine. If it skimps on environmental management, it saves some money (a benefit), but increases the risk of a major pollution disaster (a harm). The harm is a limited one, as far as the investors are concerned: at most, they will lose the amount of their investment. Any remediation costs or other liabilities above that amount will be for the public or other parties to bear. The risk is thus shared between the investors and the public. However, the benefit of money saved on environmental safeguards is for the investors alone to enjoy.

There is thus a serious imbalance between investor risk and reward: an investor enjoys all of the potential reward of skimping on environmental protection, but only some of the potential risk. Limited liability systematically distorts the effective price that market participants would otherwise assign to environmental and social risks. The ability to externalise risks onto the community functions as a structural incentive for corporations to pay less regard to environmental and social issues that individuals would in the same position.

Corporate group structures amplify this corporate incentive to engage in risky behaviour. If a company undertakes risky operations through a specially-incorporated subsidiaries, its other assets are protected if things go wrong and the ultimate investors in the parent company get something much better than limited liability. They are no longer exposed even to the full extent of their investment in the parent, since the parent has created "limited liability within limited liability".

Additional protection from environmental risks is not a by-product of parent-subsidiary structures, but often a core purpose.[37] This is especially evident when the major business partners of the subsidiary demand a parent-level guarantee as a condition of doing business with a subsidiary. In such situations, the is no real reduction of entrepreneurial risk from the perspective of the parent, only a transferral of environmental and social risk to the public.

Again, there is a perfectly legitimate justification for limited liability within corporate groups where the risks are of a commercial nature and are transferred to parties entering into a relationship with the subsidiary with full knowledge and opportunity to bargain for their assumption of risk, or to decline the relationship entirely. However, where subsidiaries impose risks on the public generally, or on involuntary creditors, the limited liability of the subsidiary heightens the incentive for the parent to act irresponsibly.

As layer upon layer of parent-subsidiary relationships are built up, the ultimate investors in the parent company get something more akin to immunity from environmental and social risk than limited liability. Complicated corporate structures, with many individual operating companies, are common in the extractive and shipping sectors. In many shipping groups, each individual ship is frequently its own corporation, even though a parent company extracts the full profits (through dividends, return of capital, or other mechanisms) from the operation of the ship. The purpose of such structures is to limit the exposure to an environmental or other disaster to the ship itself, with the parent corporation's other assets fully protected.

Extension of liability part 1: parent-subsidiary structures

While limited liability should be retained within group structures with respect to those voluntarily entering into commercial transactions with subsidiaries, it should not used as a

[37] This point was noted matter-of-factly by the Companies and Securities Advisory Committee (CASAC) in its 2000 report on corporate groups, which stated that a so-called "benefit" of corporate group structures was "lowering the risk of legal liability by confining high liability risks, including environmental and consumer liability, to particular group companies, with a view to isolating the remaining group assets from this potential liability." See CASAC, "Corporate Groups: Final Report", May 2000, at page 3, available at www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2000/$file/Corporate_Groups,_May_2000.pdf

vehicle for externalising environmental and social risk onto the community. The solution is to impose direct joint and several liability for specified environmental and social liabilities on the parent of any “subsidiary”, as defined in sections 46-49 of the *Corporations Act*.

The relevant liabilities should include those related to the environment, human rights, and personal injury or death.

Extension of liability part 2: successor entities

Australia does not recognise the concept of successor liability. That is to say, a transfer of assets from one company to another, even if it involves the de facto transfer of an entire business as a going concern, does not trigger the assumption of non-transferred liabilities to the purchaser.

One consequence of this is that companies are able to evade contingent or future environmental or social liabilities by transferring business operations though an asset sale to another entity, which may be under common ownership, possibly at a below-market price. An asset sale may be a transaction of convenience, used to accomplish what is in effect a merger but possibly leaving the selling entity undercapitalised and unable to meet future liabilities.

An example of this apparently being attempted occurred in New South Wales in 2002. A waste disposal company called “Energy Services International”, which was wholly-owned by a Malaysian entity, had illegally stored PCB-contaminated transformer oil waste, and incurred substantial fines and clean-up costs as a result. The directors placed the company into voluntary liquidation, and sold the entire business to the orthographically challenged “Energy Services Invironmental”. (Presumably, they could continue to use “ESI” letterhead.) It also attempted, unsuccessfully, to foist the waste onto the public by disclaiming ownership of it in the liquidation process.[38]

The NSW Supreme Court noted that the evidence suggested that the arrangement was “a device by those controlling the Company to avoid liability for the contaminated waste”. Because the environmental liabilities were current, the device does not appear to have succeeded in that goal. (Energy Services Invironmental, incidentally, continues to operate in the hazardous waste disposal business in Australia.) However, the outcome could well have been different if the liabilities had been contingent or future liabilities, instead of current at the time of liquidation.

Indeed, this was precisely the situation that led ultimately to the James Hardie dispute. The stripping of assets out of James Hardie’s asbestos subsidiaries, which did not trigger a corresponding transfer of liabilities, set the stage for the undercapitalisation of the

[38] See *Environment Protection Authority v Energy Services International Pty Limited* [2001] NSWLEC 59 (15 June 2001) and *Sullivan v Energy Services International Pty Ltd (In liq)* [2002] NSWSC 937 (11 October 2002).

compensation fund. If those transfers had entailed assumption of corresponding liabilities, the dispute could have been averted from the outset.

To avoid evasion of environmental and community responsibilities through corporate shell games, and to encourage bona fide purchasers of assets to inquire carefully into any potential risks, liability for environmental and social harm should pass with the transfer of assets where that transfer involves continuity of the business enterprise.[39]

Extension of liability part 3: other responsible parties

The limited liability afforded by a corporate structure is not the only way businesses are able to evade their environmental responsibilities. Contractual arrangements such as franchising structures serve this purpose just as well.

Franchising is common in the petrol distribution sector, among others. A franchise agreement between a multinational petroleum company and a local petrol station operator has several features. First, it allows the petroleum company to specify many aspects of the retail outlet (such as its branding, pricing, and operational standards) without having any direct day-to-day responsibilities. Second, it allows the petroleum company to extract profits from the operation in return for lending the station its brand name. Finally, it insulates the petroleum company entirely from environmental and other liabilities arising from the operation of the station.

In effect, franchising in the petrol distribution sector is a way for petroleum companies to extract profits from the retail distribution business while avoiding responsibility for site remediation when nominally independent franchisees go out of business. The result is a legacy of orphaned contaminated sites, with the public footing the bill for clean-up.

There are other circumstances in which contractual counterparties should bear some of the residual risk of environmental and social liabilities. These include situations where a person is aware of significant environmental issues and has the capacity to influence decision-making, but does not take reasonable measures to minimise or avoid those liabilities. A joint venture partner with a 40% equity share might not be a controlling shareholder in a legal or accounting sense, but it is reasonable to expect that shareholder to utilise their position to seek to ensure adequate environmental management measures. The same can be said of a financer who, through due diligence, becomes aware of environmental risks but facilitates a project by extending financing without sufficient environmental conditions attached.

[39] Successor liability is an accepted concept under U.S. corporate law, where it applies at least to situations where the asset sale is a *de facto* merger. Some U.S. courts have applied the concept more broadly to situations where the purchaser "substantially continues the business of the seller", notably under the Comprehensive Environmental Response, Compensation and Liability Act. For a review of relevant cases, see Alicia Rood, "CERCLA Successor Liability: Theories of Liability", available at http://library.findlaw.com/1997/Jun/1/127681.html.

For such parties, a defence to liability for situations would be appropriate where the person made all appropriate inquiries in the circumstances and took all reasonable steps to avoid and limit the likelihood and extent of the events leading to liability.

A parallel to the imposition of liability on third parties exists in the United States, where securities underwriters are liable for material errors in public securities offer documents, subject to a "due diligence" defence.[40] This liability exists even though the issuer, not the underwriter, is the author of the offer document. In effect, the U.S. Congress decided to make underwriters the guarantors of issuers and thereby to strengthen the reliability and investor confidence in capital markets. The same mechanism could be used to create incentives for others who have access to information and influence over corporate operational matters to take reasonable steps to avoid harm to the environment and the community.

6. Mandatory disclosure of social and environmental data

Corporate disclosure of social and environmental data is important to level the playing field among businesses, provide accountability to the community, and drive improved performance.

Currently, there are at least three unfair distinctions arising out of the lack of consistent, mandatory corporate environmental and social reporting requirements in Australia:

- Differences among companies headquartered in Australia and those active in Australia but listed or headquartered overseas, where mandatory reporting requirements may be in force;

- Differences among companies voluntarily reporting environmental and social data, and thus exposing themselves to public scrutiny and possibly criticism, and those that do not; and

- Differences among industry sectors (an example of this is the proposal to require reporting of greenhouse emissions by certain recipients of diesel fuel tax rebates, but not requiring similar reporting by companies not eligible for such rebates, even if they pollute more);

The effect of these distinctions is that companies that do achieve improvements in environmental and social performance are not able to reap the full benefits of those improvements, since poor performers are insulated from criticism. The lack of comparability and availability of data also hinders the ability of innovators to demonstrate their leadership position by benchmarking against their competitors.

[40] See *Securities Act 1933*, sections 11-12 (15 U.S.C. ss 77k & 771(a)(2)).

An exhaustive review of reporting across the EU in 2001 concluded that "Companies will only compete on environmental performance (as well as on price and quality) if high-quality information is freely and easily available to the market. Transparency and information are prerequisites for environmental competition."[41] Currently in Australia, such competition on environmental performance occurs infrequently at best, and is fundamentally hindered by a basic lack of information on which companies and markets can reliably judge which companies are performing well.

Aside from being a powerful way of ensuring that good performers are able to capitalise on their positive initiatives, the public also has a right to know who is polluting the atmosphere, who has a poor OH&S record, who is squandering scarce water resources. Public exposure of poor performers is a legitimate and effective way of driving performance improvements.

This data is also necessary for the efficiency of capital markets. Without data on CSR performance levels, investors do not have the information they need to assess fully the effect of those issues on the financial prospects and performance of individual companies. The lack of such information means that there is little incentive for mainstream financial analysts to take into account information on emissions or water use, for example, even where a single company makes such information available, since the analyst is not in a position to compare that company's position with its competitors.

The need for baseline environmental and social data is even more crucial in the fast-growing ethical or sustainable investment sector. For sustainable investors, information on environmental performance is a core aspect of investment selection methodology. Such methodologies have been proven to perform above the market if done well, and are increasingly accepted as successful financial strategies. One example is the recent award of the Standard & Poor's 2005 Australian Fund Award in the "Balanced Funds – Neutral" category to the Australian Ethical Balanced Trust, a fund with a "deep green" investment philosophy and investment selection methodology.

For such funds, meaningful environmental and social data are as essential as good financial accounts, and it is time that our regulatory structure supported their data requirements as well as those of investors and fund managers who limit themselves to purely financial metrics.

Existing mandatory and voluntary disclosure of social and environmental data is inadequate and far below international standards.

Currently in Australia, mandatory environmental disclosure requirements are weak and often unenforced, while voluntary environmental disclosure by companies is sparse at best

[41] EC Environment and Climate Research Program, "Measuring the Environmental Performance of Industry: Final Report", February 2001, page 206, available at http://cleantech.jrc.es/docs/MEPI%20FinalReport.pdf.

and often lacks rigour. Consistently trustworthy reporting is undertaken by only a handful of Australian companies.

There are three specific Australian legal requirements for disclosure relating to environmental issues. The National Pollutant Inventory is the most effective, although it is limited by the current exclusion of greenhouse pollutants (under review).

Section 299(1)(f) of the *Corporations Act* nominally requires reporting on compliance with environmental laws, but it is so ridden with qualifications that most companies provide no meaningful information, even when they have breached environmental laws during the relevant period. Companies also commonly read a “materiality” qualification into the clause, which eviscerates it. A few examples of shoddy practice are as follows:

- Coles-Myer, with 1900 stores around Australia, including environmentally sensitive operations such as petrol stations and auto repair shops, took the view in its 2003-04 report that it was not subject to *any* particular and significant environmental regulations whatsoever, and made no disclosure.

- Toll Holdings’ 2004 Annual Report made the extraordinary claim that licences, consents and approvals to use and develop land, transport goods, and dispose of wastes are not “particular and significant” regulations, since they apply to everybody who does those things. Thus Toll Holdings exempts itself from reporting on all environmental regulations that actually apply to it. This generous interpretation conveniently allowed them to leave out of their report a $30,000 penalty imposed in 2004 for a diesel spill.

- Patrick Corporation stated in its 2004 report that there were no “material breaches of environmental regulations” during 2004, even though its subsidiary Patrick Autocare was fined $22,500 plus costs for various environmental violations.

The third disclosure requirement is Section 1013DA of the *Corporations Act*, which requires disclosure by issuers of investment products of the extent to which they take into account specified ethical issues into account in their investment decision-making. Compliance is poor.[42]

[42] See Australian Conservation Foundation, “Disclosure of Ethical Considerations in Investment Product Disclosure Statements: A Review of Current Practice in Australia”, August 2004, available at www.acfonline.org.au/uploads/res_investment_product_disclosure.pdf.

These disclosure requirements do not require a company to address key environmental issues, such as waste generation, resource consumption, energy and water use, and environmental risk in its business.[43]

Two recent studies have highlighted just how sporadic Australian corporate reporting on these issues actually is. KPMG's latest international survey of sustainability reporting shows that only 23% of Australia's top 100 businesses issue a stand-alone annual sustainability report, compared to 80% in Japan and 71% in the U.K. Australia lags behind many other countries in this respect.[44] Furthermore, 13 of these Australian reports were not externally verified in any way; only 10 had the assurance of some external audit.

A study commissioned by CPA Australia indicates that rates of reporting below the very largest companies drop off even more sharply. That report was able to locate only 25 separate sustainability reports in 2003 among the ASX 500, of which 10 were not in the ASX 100. This implies a reporting rate of only 2.5% among medium-sized public Australian companies.[45]

The chart on the following page compares Australia's reporting requirements and current practice with other industrialised countries. As the table shows, Australia is lagging well behind international developments.

[43] The CLERP 9 reforms, which introduced a general requirement to report on the operations, financial position, and prospects of the reporting entity, in theory broadens the scope of environmental risk reporting. However, with no specific mention of social and environmental issues in the new section 299A of the *Corporations Act*, it is highly unlikely that this provision will result in greater disclosure of specific environmental data for most companies, and it does not appear to have had this effect to date.

[44] KPMG, "KPMG International Survey of Corporate Responsibility Reporting 2005", June 2005, figure 3, available at http://www.kpmg.com/news/index.asp?cid=1040.

[45] CPA Australia, "Sustainability Reporting: Practices, Performance and Potential", July 2005, Appendix 1, available at xxx

Australian Conservation Foundation

Comparison of Corporate Environmental Disclosure Requirements and Practice

	Australia	Canada	France	Germany	Japan	Netherlands	Norway	South Africa	UK	USA
Compliance with Environmental Laws	🟨 Corp. Law 299(1)(f) (but vague and marginal compliance)	🟩 Current and future financial and operational effects of env't protection and risk must be addressed in Annual Information Statement (AIS)	🟩 Damages paid for non-compliance; remediation efforts	🟨 BilReG of 2004 – disclosure of environmental issues material to operations or position of company	🟥 No specific requirement	🟩 Disclosure of incidents, complaints and their resolution	🟥 Major compliance orders, but only at listing of new securities	🟩 Required by JRE Listing Rules, by reference to GRI	🟩 OFR requires disclosure of environmental issues, as they relate to principal risks & uncertainties	🟨 Disclosure if liability incurred material or greater than $100K
Environmental Risks	🟥 No specific requirement		🟥 No specific requirement		🟥 No specific requirement	🟥 No specific requirement	🟨 Disclosure of risk of accidents and expected “limitations”	🟥 No specific requirement		🟨 Regulation S-K: material environmental issues (but marginal compliance)
Greenhouse gas emissions	🟥 No requirement	🟨 Required for large facilities (above 100,000 tonnes CO2-e)	🟩 Required by Article 148-3 of Decree 2002-221 ↓	🟨 EPER Register (EU requirement) for certain large industrial sites	🟥 No requirement	🟩 Required by Environmental Reporting Decree ↓	🟩 Required by Law of Accounts ↓	🟩 Required by JSE Listing Rules, by reference to Global Reporting Initiative ↓	🟨 Pollution Inventory (EU requirement) for certain large industrial sites	🟥 No general requirement, but some states require limited disclosure
Other pollutant emissions	🟩 National Pollutant Inventory	🟩 National Pollutant Release Inventory		🟩	🟩 PRTR Law				🟩	🟩 Toxic Release Inventory
Waste generation and management	🟥 No requirement	🟥 No requirement		🟥 No requirement	🟥 No requirement				🟥 No requirement	🟥 No requirement
Energy Use	🟥 No requirement	🟥 No requirement		🟥 No requirement	🟥 No requirement				🟥 No requirement	🟥 No requirement
Water Use	🟥 No requirement	🟥 No requirement		🟥 No requirement	🟥 No requirement				🟥 No requirement	🟥 No requirement
Other Resource Use	🟥 No requirement	🟥 No requirement		🟥 No requirement	🟥 No requirement	🟥 No requirement			🟥 No requirement	🟨 Some states require disclosure of raw material inputs
Product life cycle data	🟥 No requirement	🟥 No requirement	🟥 No requirement	🟥 No requirement	🟥 No requirement	🟥 No requirement			🟥 No requirement	🟥 No requirement
Environmental management policies and practices	🟥 No requirement	🟨 Must be disclosed if “fundamental to operations” as part of AIS	🟩 ↓	🟥 No requirement	🟥 No requirement	🟩 ↓			🟥 No requirement	🟥 No requirement
Environmental initiatives and targets	🟥 No requirement	🟥 No requirement		🟥 No requirement	🟥 No requirement				🟥 No requirement	🟥 No requirement
Applicability of specific requirements to international operations	🟥 No requirement	🟥 No requirement	🟨 Decree 2002-221 may apply, but legislation lacks clarity on scope	🟥 No requirement	🟥 No requirement	🟨 Implied by Environmental Reporting Decree	🟨 Implied by Law of Accounts		🟥 No requirement	🟥 No requirement
Environmental considerations in investment decisions	🟩 Required for most investment products	🟥 No requirement	🟨 Required for Pension Reserve Fund	🟨 Required for pension funds	🟥 No requirement	🟥 No requirement	🟥 No requirement	🟨 Fund managers must disclose their voting of equity securities	🟨 Required for pension funds	🟥 No requirement
% of top 100 companies releasing annual separate sustainability report	🟥 23	🟨 41	🟨 48	🟨 36	🟩 80	🟨 29	🟥 15	🟥 18	🟩 71	🟨 32
GRI reporting organisations (#; # per million inhabitants)	🟩 38 1.99	🟨 23 .73	🟨 32 .54	🟥 30 .36	🟨 124 .98	🟩 38 2.39	🟩 6 1.33	🟨 26 .60	🟩 80 1.34	🟥 75 .27

Notes:

1) The table compares reporting requirements for publicly listed companies. In some countries, certain requirements apply more broadly. For the Netherlands, statutory reporting requirements apply to approximately 300 companies with serious impacts on the environment.

2) Under “Compliance with Environmental Laws” and “Environmental Risks”, the table addresses the existence of specific environmental requirements in these categories; it does not reflect (1) general securities law requirements to disclose material risks and/or liabilities, or (2) accounting rules that may result in the disclosure of environmental liabilities in financial statements.

3) Source for number of top 100 companies reporting: KPMG, “KPMG International Survey of Corporate Responsibility Reporting 2005”, June 2005, figure 3, available at http://www.kpmg.com/news/index.asp?cid=1040. Source for number of GRI reporting organisations: GRI website, www.globalreporting.org.

Quality of regulation / practice		
🟩 Good	🟨 Mediocre	🟥 Poor

Reporting on environmental and social data by reference to the GRI framework should be mandatory for large companies.

Despite the cajoling of governments, public interest organisations, industry groups and some investors and consumers over many years, voluntary reporting is not being taken up in large numbers in Australia. Unfortunately most Australian companies have simply rejected their responsibility to report to the community, unlike in Japan where a voluntary approach appears to have achieved much greater success.

Overseas model: South Africa
Integrated Sustainability Reporting

In 2002, the King Committee in South Africa released its second Report on Corporate Governance. The “King II” Report includes a “Code of Corporate Practices and Conduct” that was subsequent adopted as mandatory by the Johannesburg Stock Exchange.

Section 5 of the Code sets out principles for integrated sustainability reporting, which requires every company to report annually on “the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices.”

Section 5.1.3 further provides, in part, that:

Disclosure of non-financial information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines on economic, environmental and social performance.

Thus, the Code requires companies to refer to the Global Reporting Initiative, but not necessarily to report on each GRI indicator if it is not material to the sustainability report.

A summary of the King II Report, including the text of the code, can be viewed at http://www.ifc.org/ifcext/corporategovernance.nsf/Content/SouthAfrica

Mandatory public reporting on environmental and social issues, using the widely-accepted framework of the Global Reporting Initiative, is the best solution to this problem.

The reporting requirements should extend beyond publicly listed companies. Entities with similar environmental and social impacts should not have different disclosure requirements merely on the basis of their ownership structure or place of public listing. Such a rule would also further perpetuate the invisibility and lack of accountability of some foreign-headquartered companies that have very large effects on the Australian environment.

For these reasons, the reporting requirement should apply initially to the largest 500 businesses in Australia, irrespective of share ownership or corporate structure, as well as to all listed companies. The existing section 299(1)(f) of the *Corporations Act* should be replaced by a general obligation to address each of the GRI indicators, either in full in the directors’ report or by reference to a stand-alone report. In addition, to ensure that the information about non-listed entities is available to the public, section 299(1)(f) should provide that companies or disclosing entities that are not listed public companies must also disclose the information required by 299(1)(f) to a database of public reports to be maintained by an appropriate authority. The Department of Environment and Heritage’s existing library of corporate sustainability reports is an existing resource that could easily be adapted for this purpose.[46]

[46] See http://www.deh.gov.au/settlements/industry/corporate/reporting/reports/index.html.

7. Elimination of perverse subsidies

Government subsidies that discourage environmentally and socially responsible corporate behaviour should be dismantled.

Corporations will not behave responsibly if the government pays them not to.

Currently, there remain a range of subsidies, tax incentives, and other government policies that reward companies for operating unsustainably. Many of these encourage profligate use of scarce resources by lowering the effective price of those resources, or encourage companies to engage in polluting or other harmful behaviour.

One egregious example of an environmentally perverse subsidy is the $1,100 million per annum fringe benefits tax concessions for use of company cars. Under the statutory formula used to calculate these concessions, the more one drives using a company car, the lower the tax rate applied to the fringe benefit. This results in the infamous "March rally", during which business executives take unnecessary road trips in order to lower their tax bill by bumping their car usage into the next higher tax bracket. Through this formula, the government hands out at least $1,100 million per year to reward the profligate use of internal combustion engines.[47]

Overseas model: Germany
Ecological tax reform

In 1999, Germany introduced a long-awaited "ecological tax reform". The core features of this were:

- Increased taxation of oil and gas products, with exemptions for socially and environmentally beneficial uses;
- Introduction of taxation of electricity use, with exemptions for environmentally beneficial generation and to avoid social hardship; and
- 90% of revenue generated used to reduce social security contributions;
- Remaining revenue directed to support for renewable energy and sustainable buildings projects;
- Overall fiscal neutrality.

Phased in over a six-year period, the reforms substantially lower the cost of labour inputs, while raising the cost of energy and resource use and thus stimulating efficiency measures. The German Federal Environment Ministry has estimated an overall reduction of greenhouse pollution of 2-3%, and the creation of up to 250,000 new jobs, as a result of the reform package. (see http://www.foes-ev.de/downloads/oekosteuerreform.pdf)

Furthermore, company cars need not be used at all for business purposes, and it is common practice for executives to receive additional cars for use by family members. Compounding the perversity of the rules, similar concessions are not available to users of more sustainable transport options, such as bicycles or public transit. Finally, the subsidy is regressive, since the concessional rates are attractive only to relatively high income earners.

The net effect of the policy is to encourage companies to structure compensation packages for their high-earning employees that reward wasteful and environmentally harmful car use.

[47] Commonwealth of Australia, Tax Expenditure Statement 2004, page 9, available at http://www.treasury.gov.au/contentitem.asp?NavId=022&ContentID=950

Unfortunately, while the FBT concessions stand out as particularly objectionable, they are far from unique. Numerous concessions rewarding fossil fuel use, including concessional rates on aviation fuel and rebates for off-road diesel fuel use, result in greater greenhouse pollution. Failure to properly price natural resources is another area of serious concern. The exemption of water from the GST, for example, does nothing to encourage water conservation measures, and gives companies a reason to use purchased water over possible substitutes, all other things being equal.

A full review of these issues is beyond the scope of this submission. A 2003 academic review identified more than $5 billion per year in perverse subsidies encouraging fossil fuel use alone.[48] Subsidies that encourage habitat destruction, water and other resource use, and other harmful activities have not yet been systematically quantified.

To address these issues, the Government should immediately repeal the most obviously perverse subsidies, such as the FBT concessions for company cars. In addition, the Government should initiate an enquiry into environmental and social taxation, with a view to (1) identifying and quantifying perverse subsidies at both the federal and state levels; (2) shifting taxation from desirable activities, such as work, to undesirable activities, such as pollution and resource consumption; and (3) evaluating structural options for embedding environmental and social considerations better into taxation and spending policy development.

8. Creation of sustainability investment incentives

The Government should create positive tax and other incentives to leverage greater private sector investment in socially and/or environmentally positive projects.

There is great scope for Australian governments to encourage more sustainable corporate behaviour by providing targeted tax incentives and other benefits for projects that have substantial environmental and social benefits. This approach seeks to shift incentives to make sustainable projects marginally more attractive than they would otherwise be. Such programs are very efficient from a budgetary perspective, since the government incentives have a substantial multiplier effect. They also have the advantage of working within existing capital markets, and thus avoid imposing any new regulatory burden on operating businesses.

This concept has been implemented on a large scale successfully in the Netherlands through a mechanism called the “fiscal green funds”. First developed in 1992, the fiscal green funds are tax-advantaged investment vehicles for certified “green” projects. The funds are set up by Dutch banks and attract primarily retail investors. Interest paid to investors from the fund is tax-free. This tax advantage is then split three ways:

[48] Chris Riedy, “Subsidies that Encourage Fossil Fuel Use in Australia”, University of Technology Sydney, Institute for Sustainable Futures, January 2003, available at http://www.isf.uts.edu.au/publications/CR_2003_paper.pdf.

- Investors receive an interest rate somewhat lower than market rates, but still earn a better-than-market return because of the tax-free status of interest payments;

- Green businesses have access to lower interest rates than they could otherwise receive, since the investors are willing to accept lower rates of return; and

- Banks are able to charge somewhat higher fees, to cover higher transaction costs and risk.

A schematic example of how it works in practice is given by Marcel Juecken in *Sustainability in Finance: Banking on the Planet*:

Table 7.1 Principles of the Dutch fiscal green regulation[49]

	Standard commercial loan	**Fiscal green funds loan**	**Difference in favour of green funds**
Net return for saver/investor	2.6%	2.8%	**+0.2%**
Tax	2.6%	0%	-2.6%
Gross return for saver/investor (= 1+2)	5.2%	2.8%	-2.4%
Funding by bank (=3)	5.2%	2.8%	-2.4%
Interest margin for bank	1%	1.4%	**+0.4%**
Interest on credit for business (= 4+5)	6.2%	4.2%	**-2%**

In this model, the cost of capital for the green project has been reduced by two percentage points, or about 35%, while both the bank and the investor have increased their returns on the investment. Jeucken reports that the tax loss for government of 10 million euro in this scheme results in an actual investment of 450 million euro in green projects. Thus, each investment of 1 euro by the Dutch government mobilizes 45 euro of private capital that would not otherwise have been directed to green projects.

Projects become eligible for funding from a fiscal green fund by applying to the Dutch government for certification, which is awarded to environmental projects in specified categories.

Leveraged private investment has been successfully implemented in the context of health care and education in Australia, and has been applied to environmental issues on a relatively small scale through the Victoria Water Trust, for example.[50] There is great opportunity to draw upon these successes to establish a national leveraged private investment scheme for environmental and social projects generally, including clean energy, sustainable land management, residential and commercial building efficiency, and many other areas.

[49] Marcel Juecken, *Sustainability in Finance: Banking on the Planet*, Eberon Delft, 2004, p. 198.

[50] For a much fuller discussion of the concept of leveraged private investment, including responses to common objections, see Allen Consulting Group, *Repairing the Country: Leveraging Private Investment*, August 2001, available at http://www.acfonline.org.au/uploads/res_private_investment.pdf.

9. Revision of insolvency and winding-up laws

Insolvency and winding up laws should ensure proper provisioning for long-tail liabilities.

The James Hardie fiasco highlighted a crucial inadequacy in the structure of Australian external administration procedures. In that case, a central problem was that the interests of “unascertained future creditors” of certain of James Hardie’s subsidiaries – an inchoate but large group of people who will in the future have claims against the manufacturers of asbestos products to which they were or will be exposed – were not and could not legally be taken into account in external administration.

As the Jackson Inquiry noted:

> *All parties to the Commission were agreed that the current arrangements available to the [Medical Research and Compensation] Foundation under the Corporations Act to manage its liabilities are inadequate. The essential difficulty is that none of the external administration mechanisms under the Act recognises the position of persons in the category of unascertained, future creditors, such as future claimants in respect of asbestos disease for which [James Hardie subsidiaries] Amaca and Amaba will be liable.*[51]

While the inquiry stopped short of endorsing specific legislative changes, Mr Jackson did note that “unless some general reform is enacted that permits external administration to deal with long tail liabilities, future cases will arise that will have to be the subject of ad hoc legislative solution, if serious injustice is to be avoided.”

One of the flaws highlighted in this case is that the *Corporations Act* does not recognise unascertained future creditors as “creditors” within the context of external administration. Thus, a corporation can be wound up and its assets fully distributed to creditors and investors, while individuals and communities whose claims against the corporation will become evident only in the fullness of time fall through the cracks of the insolvency system.

The problem is not only in the context of product liability matters. Other long-tail liabilities may include environmental remediation and/or toxic tort claims. For example, unremediated site contamination may lead to health problems and personal injury claims long after the corporation that polluted the site is wound up. The public may also be an unascertained future creditor in such cases, if the burden of cleaning up a site falls on public authorities.

To ensure that long-term social and environmental issues are fully taken into account in the external administration of a company, the following reforms should be pursued:

[51] Report of the Special Commission of Inquiry Into the Medical Research and Compensation Foundation, page 551, available at http://www.cabinet.nsw.gov.au/publications.html.

- External administrators should be required to undertake a reasonable investigation in the circumstances into the existence and magnitude of any unascertained future claims, and to ascertain if possible the identities of potentially affected claimants;

- Where possible unascertained future claims have been identified, a representative of possible future claimants (including the public generally) should be appointed to represent their interests; the representative should have appropriate investigative powers and standing analogous to that of a creditor in all proceedings; and

- The interests of claimants whose claims are wholly prospective but reasonably likely to arise (whether they can be specifically identified or not) should be considered as equal in all respects to current, contingent, and future creditors' interests. Where claims are identified as reasonably foreseeable but the identities of claimants is not clear, a compensation fund should be set aside to provide for future payment of such liabilities, with an adequate margin for error.

A positive side-effect of these changes may be an increase in the vigilance and due diligence of financial investors on potential long-tail liabilities, since the class of creditors in an insolvency proceeding would be expanded if such liabilities exist. It is reasonable to expect a corresponding modest reduction in the risk of such liabilities in the first place.

Finally, costs of environmental remediation should be given priority over residual claims in insolvency proceedings. In particular, a section 556(1)(i) should be added to the *Corporations Act*, establishing "any actual or future environmental remediation costs or other environmental liabilities" in the priority of debts just below injury compensation and employee entitlements but above general unsecured debts. This will ensure full payment of environmental liabilities rather than proportional treatment alongside general creditors and, again, may increase somewhat the attention of creditors to environmental management of the company.

10. Remedies for unethical overseas conduct

Australia should implement the U.N. Human Rights Norms for Business, and provide a remedy for breach of those norms.

While many Australian companies operate in overseas jurisdictions responsibly, unfortunately hard experience has demonstrated that some companies are willing to take advantage of conditions in developing countries to engage in exploitative activities that would be totally unacceptable in Australia.

Examples of Australian companies acting irresponsibly outside of Australia include the following:

- The disastrous pollution of the Fly River in Papua New Guinea by riverine disposal of mining waste from BHP's mine at Ok Tedi, which resulted in widespread environmental devastation and destruction of resources essential to local communities;

- The lethal cyanide spill caused by Australian gold miner Esmeralda (now Eurogold) in 2000 from its mine at Baia Mare in Romania, which turned large stretches of the Somes, Tisza and Danube Rivers into a dead zone. Esmeralda denied that it was responsible, downplayed the scope of the calamity, and then when evidence of its magnitude was incontrovertible, placed itself into voluntary administration in an obvious attempt to protect its assets before the extent of liability could be fully assessed;

- The apparent complicity of Perth-based Anvil Mining in human rights atrocities in the Congo in October 2004. Anvil has stated that it acceded to a request from the Congolese military to use Anvil's vehicles in a military operation; that operation resulted in the execution of unarmed civilians. Anvil apparently had taken no steps to ensure that did not support the activities of a military well known for human rights abuses. When questioned about the use of Anvil's vehicles in this way, CEO Bill Turner replied, "So what?"

These examples and others demonstrate that the laws of the countries in which these companies operated, their voluntary commitments, and the risk of damage to their business or reputation were all insufficient to deter the companies from engaging in irresponsible or even brutal conduct. The Anvil Mining case in particular highlights the fact that even today Australian companies will not always observe even the most basic standards of environmental care and human rights when operating outside of a reliable regulatory structure.

In countries without developed systems of substantive legal protection or the enforcement capability to ensure they are complied with, or where governments are corrupt or have collapsed completely, domestic regulation cannot be relied upon to ensure that Australian companies behave decently.

The United Nations Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights seek to ensure that businesses act responsibly in the areas of human rights and consumer and environmental protection.[52] Adopted by the United Nations Sub-Commission on the Protection of Human Rights, the norms are the best statement of principles regarding businesses' obligation to respect basic human rights.

Australia should translate these norms into domestic law, by creating a right of action in Australian courts for persons injured by any breach of the norms.

[52] Available at http://www.unhchr.ch/huridocda/huridoca.nsf/(Symbol)/E.CN.4.Sub.2.2003.12.Rev.2.En?Opendocument.

Australia has already implemented legislation that extends the reach of Australian law overseas in a variety of cases, including terrorism, war crimes, crimes against humanity, trafficking in persons and even contamination of goods.[53] The same should be done for fundamental breaches of basic human rights standards by Australian companies, wherever they may operate.

In each of these cases, Parliament determined that the severity of the conduct and the fundamental importance of the interests those laws protect justified extraterritorial legislation. These laws were passed over the traditional objections to extraterritorial legislation, such as deference to governments of foreign jurisdictions, the desire to avoid potentially conflicting legal regimes, and enforcement difficulties. Ensuring that business operations are conducted in accordance with basic environmental, social and human rights standards is of similarly crucial importance.

11. Promotion of institutional reform and capacity-building

Institutional reform 1: Australian Securities and Investment Commission.

The Australian Securities and Investment Commission (ASIC) has demonstrated little interest in development or enforcement of corporate law as it pertains to environmental and social issues, even where legal obligations currently exist.

ASIC has refused to take action on even the most blatant breaches of disclosure laws regarding environmental issues, on its own or even when those breaches are brought to its attention. For example, in March 2004, a uranium leak at the Ranger mine in Kakadu National Park resulted in the poisoning of at least 24 workers, the temporary shutdown of the mine, a range of audits and required investment in improved environmental management, and ultimately a successful criminal prosecution of the company. The incident was plainly price-sensitive and was material in both a financial and non-financial sense, yet the owner, Energy Resources of Australia, neglected to disclose it to the market until a full six days after the incident. ASIC declined to take any enforcement action.

More generally, we are not aware of a single instance of ASIC taking action to ensure compliance with the environmental reporting requirements in section 299(1)(f) and 1013D(1)(l) of the *Corporations Act*, either with respect to an individual company or particular sensitive industry sectors. This is despite evidence of regular non-compliance with both of those reporting requirements.

It would appear that ASIC is not attuned to the needs of the sustainability investment sector, which relies on accurate information about the environmental and social impacts of companies.

[53] See, for example, *Criminal Code Act 1995*, sections 101.1-103.1 (terrorism and related offences), 268.117 (genocide, war crimes and crimes against humanity); 270.5 (sexual servitude), 271.10 (trafficking in persons); 380.5 (contamination of goods).

The Government should create a unit at ASIC, with dedicated expertise and capacity in the area of corporate responsibility, responsible specifically for monitoring corporate compliance with disclosure and other obligations as they relate to environmental and social issues.

Institutional reform 2: National Corporate Responsibility Commissioner.

The issues addressed in this inquiry are complex and wide-ranging. Furthermore, implementing voluntary or mandatory initiatives to improve corporate responsibility, continuing development of sound policy on corporate responsibility, and coordinating the efforts of the diverse range of government authorities in this area will all require ongoing, dedicated expertise. There is currently no obvious governmental responsibility in this area. Some discrete corporate initiatives are undertaken by the Department of Environment and Heritage, but of course questions of corporate responsibility extend well beyond the environment portfolio.

The Government should create the office of a National Corporate Responsibility Commissioner, with responsibilities for those tasks and sufficient resources to continue sensible policy developments and to carry out the needed reforms.

Institutional reform 3: Government reporting, procurement, and internal performance.

While the Australian Government has made some advances in its own procurement, reporting and environmental and social performance commitments, overall there is still much progress to be made. Two departments (DEH and FACS) have issued triple-bottom line reports, but the bulk of the federal government appears to have made little headway on reporting and reducing their own social and environmental impacts. The federal government as a whole should issue a triple bottom line budget alongside the annual financial budgetary processes.

Furthermore, a serious, whole-of-government approach to responsible, environmentally sound procurement and operations must be undertaken if the government expects businesses to do the same. For example, the government should commit to becoming carbon neutral over the next five years, as a number of private companies have already done. Such practices are valuable as examples and demonstrations of commitment, as well as enabling improved social and environmental performance by the government itself.

Finally, the government can support corporate responsibility by monitoring the effects of economic behaviour on the environment and our society in a more balanced, systematic way, and incorporating those measurements better into policy-making. Currently, macroeconomic health is generally measured by indicators such as GDP, which is wholly inadequate for gauging the long-term health of a society. This is because the GDP measures only the benefits of a given activity, and none of the costs. For example, the clean-up of a contaminated site generates employment for environmental remediation experts, which shows up as a positive contribution to the

GDP. However, none of the ills attributable to the contaminated site – such as the waste of resources that could be put to more productive uses, and the damage to the health of individuals and ecosystems – are taken into consideration.

The result of the widespread focus on the GDP is that environmental, social and other policies as they relate to corporate behaviour are structured to maximise an incomplete view of economic progress. Those policies will then tend to compromise our collective wellbeing and the long-term sustainability of our economy in the pursuit of short-term benefits.

The development and adoption of more sensible and balanced metrics for what we as a nation should strive for will help us to achieve a more sustainable future economy. The work by the Australian Bureau of Statistics on measuring Australia's progress, including a range of indicators separate from GDP, is a step in the right direction. However, even at the ABS GDP is still the headline indicator, and they have not yet accepted any environmental indicators as "key national indicators". The government still relies heavily on the GDP and similarly narrow indicators as the basis for actual policy formulation. Replacing the GDP by a more balanced set of measures, such as the Genuine Progress Indicator (GPI), can be expected to encourage policies across the board that better encourage responsible business activity.[54]

END

For more information, please contact
Charles Berger
Legal Adviser
Ph: (03) 9345 1173
email: c.berger@acfonline.org.au

FLOOR ONE, 60 LEICESTER STREET **CARLTON VIC 3053**
phone ■ **03/ 9345 1111** // facsimile ■ **03/ 9345 1166**
email ■ **acf@acfonline.org.au** // web ■ **acfonline.org.au**

The Australian Conservation Foundation is committed to achieve a healthy environment for all Australians. We work with the community, business and government to protect, restore and sustain our environment.

[54] For information on the Genuine Progress Indicator, as developed by The Australia Institute, see www.gpionline.net.

Submission to the Corporations and Markets Advisory Committee
Corporate Social Responsibility
By
Dr. J. Raar,
February, 2006.

Corporations and Markets Advisory Committee
Corporate Social Responsibility
Discussion Paper.

Attention: Mr. John Kluver

SUBMISSION ON ASPECTS OF SECTION 4 (4.8) IN THE TERMS OF REFERENCE, NAMELY:

> *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities? (Page 101)*

Research undertaken during a Ph.D albeit in the middle nineties, together with more recent research efforts indicate the following:

- Industry requirements have prompted firms to adopt environmental and social reporting.
- Industry standards and their strategic requirements initiate environmental and social business practices, which are more discernible if profits are favourably impacted.
- The reporting of environmental and social impacts resulting from corporate activities is currently minimal and of a voluntary ad hoc nature, with inter and intra firm comparability a concern.
- There is a considerable ‘gap’ between the information provided internally, and that reported to external stakeholders, thus reducing the reliability of the information communicated.[1]

The approach undertaken in this submission is to contend that:

a) strategic planning and control systems offer a mechanism for firms to ‘reorchestrate’ responsibilities and linkages to the environment and other corporate citizenship values.

b) life-cycle assessment is a management technique to assist in this objective.

[1] References are available upon request.

Therefore, in a general answer to the questions raised on Page 101 of the Discussion Paper, the following recommendations are provided:

1. To assist intra and inter firm comparability, mandatory standards for environmental and social reporting should be:
    - industry-based with a longer term focus.

2. The basis of these reporting standards would be the:
    - Strategy adopted by the industry, and its corresponding inclusion in the strategic stance of the individual firm.
    - The end of period comparison of actual performance to the specified industry stance.

3. Initially areas of values to be applied can include:
    1. T*he overall goal of utilitarianism for the community*, and how the industry and individual firms will incorporate this goal into daily operations. Individual industry sectors will provide supportive objectives that then flow into the individual firms operating within their specific jurisdictions, including:

    - Environmental and social objectives
    - Workplace objectives (applicable also to global activities)
    - Community objectives
    - Product and service objectives
        - Source and use of raw materials
        - Technological inputs to reduce the use of natural resources.
        - All emissions (goals and performance).
        - Ecological footprints.

4. Importantly, the strategic stance information must be consistent with internal reporting systems, including the control mechanisms and reporting benchmarks. Hence the audit function/s would enable the confirmation of the information reported to the public.

5. The format for the reporting on strategic information may contain narrative information. Nevertheless, consistent with the idiom 'what gets measured – gets managed' then the benchmarks for performance and associated reporting will be quantitative. Currently Total Quality Management benchmarks are reported internally in nonfinancial terms. 'Corporate citizenship' performance measures are also suitable for reporting in non-financial terms.

6. To aid understanding and comparability, the financial results will exclude the quantification of items such as intangibles. Supplementary information in a consistent triple bottom line reporting format can also be included in financial or nonfinancial terms, as outlined above.

7. The mandatory requirements for financial reporting are stated in the Corporations Act. However, the formal guidelines and procedures to conform to this requirement are contained in accounting standards. A similar requirement for citizenship reporting (triple bottom line) is feasible.

   Correspondingly industry groups would pre-determine their own benchmark specifications.

   For individual firms, nonfinancial measurement and benchmarks are used within internal information systems, and fall within the jurisdiction of the accounting and auditing profession. These control and/or internal benchmarks can then be accumulated/summarised and transferred to external reporting requirements.

8. The reporting of environmental impacts has, and remains the topic of interdisciplinary and international studies. The evolvement by the Global Reporting Initiative of the measurement in quantitative terms of the 'ecological' footprint is encouraging, however, the time frame and boundaries of association require specification and predetermination. For some industries and firms the life cycle of their product may be determinable and the impacts measurable within a specified jurisdiction of boundaries and time horizons. Others industries and firms may not be in a similar position.

   (a) Importantly, the reporting of impacts will include the potential for risk. Any risk will ultimately impact of the financial results of the firm, and eventually reside with ordinary shareholders should this not be averted. Pollution and health effects arising from management decisions taken a number of years ago, may impact on current cash flows in terms of clean up costs or litigation claims.

   (b) In the process of formulating a strategic approach is integration of the time dilemma for differing values, i.e. one year for economic performance measurement, ten to fifteen years for pollution prevention outcomes, and up to fifty years for total environmental impacts to be manifested in observable effects.

   (c) Therefore the reporting of impacts and risk can be:

      - In accordance with industry goals and those of the individual firm
      - Specified according to boundaries and jurisdiction of the industry and corresponding reporting entity

- Specified in accordance with a time-frame that is consistent with environmental impacts flowing from the industry group and the individual entity.

In summary, this approach offers external parties the accountability of directors against two aspects, (a) their adherence strategic stance of the industry, and (b) the related goals and performance of the individual firm.

Therefore, the collective input of industry groups would assist in disseminating goals and objectives. Those industries and firms which are conducting their business activities outside social and community values, would be placed in a 'must do' position. (In an ideal world all firms would morally embrace corporate citizenship values without any necessity to 'prompt' them).

The aforementioned recommendations are consistent with communities and cultures throughout the global community and may be transferred internationally at both industry and firm levels.

Jean Raar Ph.D
Senior Lecturer in Accounting
School of Accounting, Economics and Finance
Faculty of Business and Law
Deakin University,
221 Burwood Highway,
Burwood. Vic. 3125.

Email: raar@deakin.edu.au
Telephone: 61 (03) 9244 6470.

Note: This viewpoint expressed in this document is that of the researcher and does not purport to represent that of Deakin University.

UniSuper

27 February, 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver,

CORPORATE SOCIAL RESPONSIBILITY DISCUSSION PAPER

Thank you for the opportunity to provide a response to the Corporate Social Responsibility Discussion Paper, prepared in November 2005, by the Corporations and Markets Advisory Committee (CAMAC).

UniSuper is the superannuation fund for Australia's higher education and research sector with approximately 360,000 members and funds under management of $18 billion as at January 2006. UniSuper is also a founding member of the Australian Council of Superannuation Investors (ACSI) (www.acsi.org.au) and a member of the Global Investment Governance Network (GIGN) through which it supports corporate governance initiatives from time to time.

In preparing its response, UniSuper has referred to the Terms of Reference (P vii – viii) in the Introduction of the Discussion Paper and addressed the following four questions:

1. *'Should the Corporations Act be revised, to take into account a greater extent of interests of specific classes of stakeholders or the broader community when making corporate decisions?'*

UniSuper believes that the Corporations Act, in conjunction with Australian Federal, State and Local laws and specific legislation such as the Environmental Practices Act and Occupational Health and Safety Act, enables directors to account for a wide range of interests, including Corporate Social Responsibility. As such, UniSuper feels that there is sufficient protection for specific classes of stakeholders and the broader community under current legislation, and that the Corporations Act need not be revised.

Trustee: UniSuper Limited
ABN 54 006 027 121
Administrator: UniSuper Management Pty Ltd
ABN 91 006 961 799
Australian Financial Services Licence No. 235907

Head Office
Level 37, 385 Bourke Street
Melbourne VIC 3000
Telephone 03 9691 4100
Facsimile 03 9691 4141
www.unisuper.com.au

2. *'Should the Corporations Act be revised, to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?'*

The Corporations Act requires that directors are to act 'with care and diligence' (s180(1)), in matters of business judgment, (s180 (2)) and 'in good faith and in the best interests of the corporation' (s181 (1)(a)). Moreover, the Business Judgment Rule (s180(2)), allows for a director to form a reasonable judgment, taking into account all relevant information on the risks and return of an investment, and may conceivably include consideration of Corporate Social Responsibility risk, if material to the business. As such, the Corporations Act already allows directors to take into account specific classes of stakeholders or the broader community when making corporate decisions, and should not be revised.

3. *'Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?'*

UniSuper's policy is that companies should be encouraged to adopt socially and environmentally responsible business practices, where it is material to the economic case. UniSuper regards voting, and in some circumstances corporate engagement, to be useful to encourage socially and environmentally responsible business practices. By following recognised voluntary standards, such as The Global Reporting Initiative, companies can adopt socially and environmentally responsible business practices, and report accordingly.

4. *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*

UniSuper believes that all companies should be encouraged to report on Corporate Social Responsibility in the same way that listed Australian companies are currently required to report on the Australian Stock Exchange (ASX) Principles of Good Corporate Governance Best Practice Recommendations. Corporate Social Responsibility could be reported on, consistent with using the 'comply or explain' approach, through an entity such as the ASX.

Conclusion

UniSuper does not support a revision of the Corporations Act in relation to the matters raised and believes that there is sufficient protection for specific classes of stakeholders and the broader community under current Australian legislation. Moreover, UniSuper considers that companies should be encouraged to adopt socially and environmentally responsible business practices, by requiring them to report on the social and environmental impact of their activities on a 'comply or explain' basis.

For further information, please contact Helga Birgden, Manager, Governance and Sustainable Investment on (03) 9691 4221.

Yours sincerely,

Ann Byrne
Chief Executive Officer

Australian Centre for Corporate Social Responsibility

PO Box 2371 / Caulfield Junction VIC 3161 / AUSTRALIA
T: +61 3 9576 1694 / F: +61 3 9576 1517 / E: info@accsr.com.au / W: www.accsr.com.au
ABN: 71 007 029 610

30 September 2005

Submission to the Inquiry of the Parliamentary Joint Committee on Corporations and Financial Services into Corporate Responsibility

The Australian Centre for Corporate Social Responsibility (ACCSR) welcomes the inquiry into Corporate Responsibility by the Parliamentary Joint Committee on Corporations and Financial Services.

ACCSR is an independent corporate social responsibility (CSR) advisory and training firm. Our services facilitate improved corporate social responsibility through consulting on CSR policy, strategy, capabilities and programs, provision of Australia's leading executive development learning programs in CSR, and CSR research and evaluation.

This submission is prepared together with Paul Hohnen, an internationally-based Australian consultant active in several global CSR processes and instruments.

We consider that government has a crucial role to play in supporting and enhancing improved corporate social responsibility. Section 181 of the Corporations Law does not prohibit corporate social responsibility, but neither does it specifically encourage it. Companies may not necessarily interpret "good faith" and "best interests of the corporation" to consider responsibility to the wider set of stakeholders who contribute to a corporation's wealth.

Currently, we have no empirical basis for understanding the extent to which corporations currently may have regard for the interests of non-shareholder stakeholders. This is a question for further research.

Indeed, many have argued that Section 181 precludes corporate social responsibility because directors might breach their duty to act in the best interests of shareholders if shareholder interests are seen to conflict with other stakeholders' interests (Wilson, 2005). Although broader stakeholder interests are protected to a degree by other legislation, we argue that greater government involvement is required to combat "short-termism" (BCA, 2004), and to ensure that the leadership shown by a handful of corporations is not dissipated over time through lack of institutional endorsement and legitimacy.

Government plays an important role to play in creating an "enabling environment" for CSR. For example, a recent review of US government activity that facilitates CSR used a World Bank framework for understanding the ways in which governments can support corporate social responsibility; namely, endorsing, facilitating, partnering and mandating (Yager, 2005).

The Australian Federal Government provides endorsement for one aspect of corporate social responsibility through the Prime Minster's Community Business Partnership Awards, and facilitates information about other aspects of corporate social responsibility through the OECD national contact point and some initiatives within the Department of Sustainability and Environment. However, these efforts, though laudable, are not sufficient[1]. Further, the Government sends conflicting signals to business about CSR when it supports these activities while at the same time voting against the appointment of a United Nations Special Representative on human rights[2]. The Government must do more to support CSR, and apply a consistent approach.

Specifically, we recommend:

1) Increased disclosure of corporate social and environmental impacts through mandatory reporting for corporations of a certain size;
2) Increased policy leadership by Government through appointment of a Minister for Corporate Social Responsibility;
3) A review or audit of Government activities that complement or support corporate social responsibility;
4) That Government convene a multi-stakeholder Forum on CSR involving business, government, civil society and mediating institutions to facilitate greater knowledge and development of CSR;
5) Increased support for the Australian Standard on Corporate Social Responsibility AS8003 through development of a certification program, with associated training and development support;
6) Government support for research on international trends on CSR, including on how CSR might help in developing Australia's international profile and competitive position in the global market place.

THE CASE FOR INCREASED GOVERNMENT SUPPORT OF CORPORATE SOCIAL RESPONSIBILITY ACTIVITY

Corporate social responsibility is a business strategy for creating long term value for both corporations and the societies they depend on. CSR achieves this goal by minimising negative social and environmental impacts and maximising positive social and environmental impacts. Socially responsible companies are therefore those that are accountable for the social and environmental impacts of their operations and actively manage opportunities and risks that arise from their social and environmental impacts.

One of the main reasons that Australian organisations are not currently more engaged in socially responsible behaviour and triple bottom line reporting is largely because there are, to date, no legal requirements to do so. Despite the "good faith" obligations and requirements for reporting on specific environmental regulations prescribed respectively in Sections 181 (1) and 299 (1)(f) of the *Corporations Act 2001* (Cth), there is little legal onus on Australian organisations to report the social and environmental impacts of their commercial practices to the wider Australian community. Consequently, while the current legal framework permits social responsibility by Australian companies, the failure to actively encourage it through enhanced reporting, policy, regulatory and certification processes does little to encourage or increase its practice.

[1] We acknowledge that a range of government departments and instrumentalities may provide encouragement for CSR.

[2] We refer to Australia's vote on 20 April 2005 against the UN Secretary General's appointment of a Special Representative on the issue of Human Rights, Transnational Corporations and Other Business Enterprises. Australia was one of only three countries to do so, the others being South Africa and the USA.

Companies that commit to adopting and implementing CSR strategies and practices are, by their nature, more stable and openly accountable organisations, and hence more likely to be profitable. The simple act of disclosing social and environmental impacts helps to build confidence within consumer and investment markets, while demonstrated willingness to address the concerns of the community will often lead to greater customer loyalty, market differentiation and improved brand reputation.

Attention to CSR helps employers create a working environment in which workers feel that their values are aligned with the values of their employer. This in turn increases the likelihood of improved employee commitment and productivity and retention and attraction of quality staff. When a company is accountable for its social and environmental impacts, conflict with stakeholders is reduced. Our research shows that corporate social responsibility accounted for 12% of variance in business performance and the effect of CSR on business performance is partially mediated by conflict reduction effects (Black & Hartel, 2002).

The impacts of market deregulation, specifically in the context of increased economic globalisation, have thrust many large corporations into powerful positions of economic and political influence. In practice, this power has been coupled with a greater sense of freedom and increased economic rights. Nevertheless, as Westpac Chairman Leon A. Davis acknowledged, "with greater rights comes greater responsibilities," and thus as corporations become ever-more powerful, the community has a right to demand ever-more from them in return (Davis, 2001).

Given the positive effects of CSR on business, on its stakeholders and the wider community, Government has a strong case to support increased CSR through actively creating an enabling environment of CSR.

A World Bank report on the role of government in facilitating corporate social responsibility identified four possible roles for government: mandating, facilitating, partnering and endorsing (Fox, Ward, & Howard, 2002). The report identified ten government activity areas to support CSR:

- Setting and ensuring compliance with minimum standards
- Public policy role of business
- Corporate governance
- Responsible investment, philanthropy and community development
- Stakeholder engagement and representation
- Pro-CSR production and consumption
- Pro-CSR certification, "beyond compliance" standards and management systems
- Pro-CSR reporting and transparency
- Multilateral processes, guidelines and conventions

In addition to supporting the adoption of these 10 governmental activities, we suggest that government can provide leadership in this area through the establishment of a ministerial portfolio for social responsibility. In the remainder of this submission, we make several recommendations for government activity, while recognising that there are an even wider range of activities that would be fruitful for government to consider and adopt.

THE CASE FOR MANDATORY SOCIAL AND ENVIRONMENTAL REPORTING

The extent of voluntary social and environmental reporting in Australia is one indicator of the extent to which companies take into consideration the broader interests of stakeholders other than shareholders.

The Global Reporting Initiative (GRI) is a framework for non-financial reporting that is rapidly becoming the de facto global framework for social and environmental reports. The GRI database lists 38 Australian reporters. Other research has shown that less than a quarter of

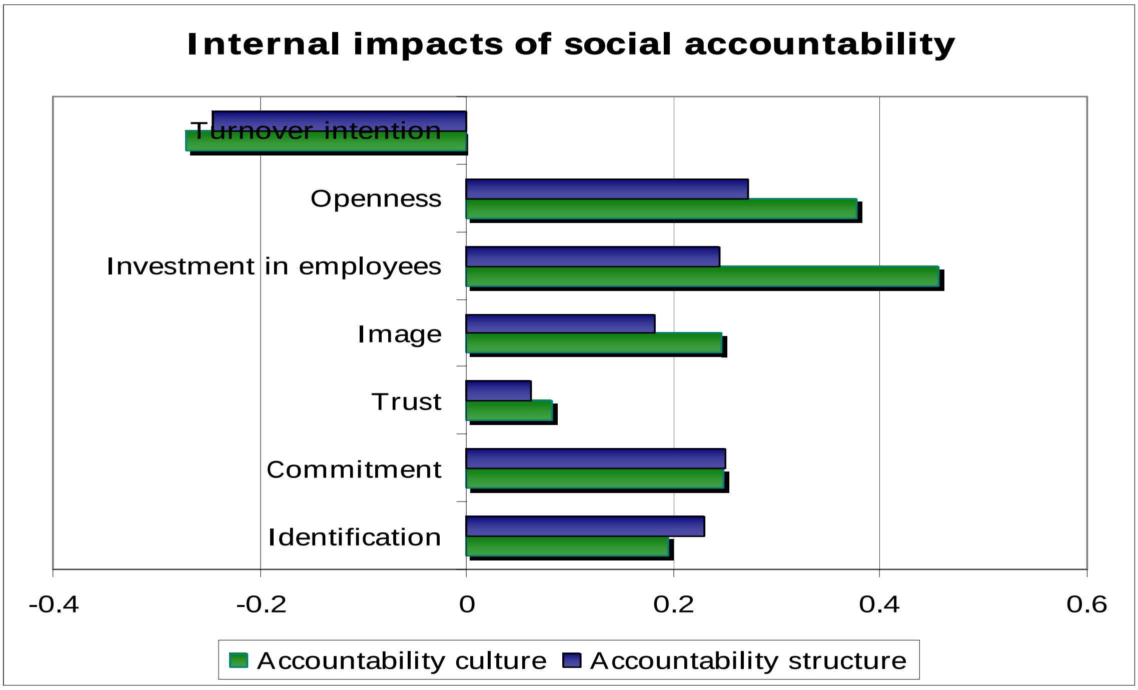
ASX 100 companies produce an annual social or environmental report (KPMG, 2005) or that only 31 of the ASX top 500 issue such a report (Frost, Jones, Loftus, & Van der Laan, 2005). By comparison, KPMG reported that over half the world's top 250 companies issue a social or environmental report.

Compared to other developed countries, the level of voluntary social and environmental reporting in Australia is low.

Companies voluntarily disclose their social and environmental policies and impacts for a range of reasons, such as improving decision-making or satisfying stakeholder demands (Adams, 2002). However, a growing body of empirical research around the world demonstrates that foremost among the reasons for reporting is the desire to improve the corporate image and to be seen as acting in good and proper ways (Adams, 2002; Bansal & Roth, 2000; Campbell, 2000; Deegan, Rankin, & Tobin, 2002; Hooghiemstra, 2000; Livesey & Kearins, 2002). Thus, reputational benefits are among the foremost drivers of voluntary social and environmental reporting.

In addition, companies receive internal benefits of reporting. Our research shows that the benefits include reduced employee intention to leave (turnover intention), increased workplace openness and trust, increased commitment of employees and improvement of their image of their employer, and an increased propensity of the reporting organisation to invest in their employees through actions such as career development assistance (Black, 2004). These benefits are depicted in Figure 1.

These outcomes are significant for both organisational culture and the structure through which accountability to stakeholders is delivered. Managers report that these outcomes are possible because the act of reporting stimulates thinking within the organisation about its broader relationship with stakeholders.



Greater disclosure of social and environmental impacts would be very beneficial for a wide range of stakeholders, including employees as noted above, and investors. A recent study of long-term Australian institutional investors showed that they believe that not enough attention is being paid by listed companies to corporate social responsibility, and that CSR is an important driver of value. However, they lack information about corporate social and environmental impacts and risks on which to base their assessments (Coghill, Black, & Holmes, forthcoming). The combination of rising inflows into superannuation and the expanding globalising of Australian business, with accompanying increases in social and environmental risk, mean that investors will increasingly demand such information in the future. They will need data that is comparable across companies and industries. Mandatory disclosure of social and environmental impacts will be an effective way to address this need.

Some leading Australian social reporters have argued that social reporting here is an emergent practice and that mandatory reporting could stifle innovation in reporting. This argument is spurious for at least two reasons. First, voluntary reporters are converging around the GRI reporting guidelines which are beneficial for both reporters and stakeholders as they enable comparability across companies and industries. Standardisation rather than innovation is thus the observed trend in reporting. Second, the introduction of mandatory social reporting in other countries such as France and the United Kingdom has led to no reported decline in innovation. Indeed, the selection of relevant indicators and the style of reporting in these countries remain at the discretion of individual companies, since companies will vary in the nature and range of impacts.

It is important for members of the Inquiry to understand the motivation behind the apparent paradox that some of Australia's leading social reporters oppose mandatory social reporting. If reporting were mandatory, the leaders would lose the reputational benefit of reporting. After all, companies do not improve their reputation by publishing a profit report; they improve it by producing a superior profit. Likewise, companies may not gain a reputational benefit from mandatory social and environmental reporting, but they would gain a reputational benefit by producing positive social impacts and minimising or removing negative social and environmental impacts. While Australia continues to lag other countries in social and environmental reporting, Australian reporters gain an even greater reputational benefit as they are seen to be international leaders while the rest of business remains "as usual".

We do not in any way suggest that voluntary reporters are producing "spin and not substance". Far from it. Companies rarely undertake voluntary social and environmental reporting unless they have made significant investments in understanding and managing their social and environmental impacts. We do, however, suggest that voluntary reports are important communications tools for companies that help to build reputations for social responsibility. Therefore, mandating the production of such reports would void the reputational benefit. Companies that have made such investments naturally do not wish to lose the reputational benefit and will argue in favour of continued voluntary reporting.

Further, companies that have made no significant investment in understanding and managing their social and environmental impacts are very unlikely to welcome additional regulatory and reporting requirements. Therefore, very few companies at all are likely to favour mandatory social reporting.

In deciding whether to support mandatory disclosure of social and environmental impacts, the Inquiry should focus on the needs of stakeholders, including communities, employees, suppliers and investors who need such information for balanced and considered decision-making.

The UK's Operating and Financial Review (OFR) Guidelines form a recent template for government activity from a country with which Australia has much in common, including a shared legal heritage[3].

[3] See http://www.societyandbusiness.gov.uk/ukpolicy.shtml

RECOMMENDATION 1: We therefore recommend that the Australian Government adopt OFR-style regulation that encourages companies to disclose and report on their CSR performance by requiring directors to produce a "fair review" of their company's business, that is independently audited, and subject to appropriate regulatory oversight and enforcement.

THE CASE FOR APPPOINTMENT OF A MINISTER FOR CORPORATE SOCIAL RESPONISIBILITY

The Australian Government may have numerous ways in which it encourages corporate social responsibility, but a lack of coherence and focus of initiatives and policies makes this difficult to ascertain. Consequently, a lack of government leadership on this issue makes it easy for companies to apply a narrow interpretation to Section 181 of the Corporations Act and disregard responsibilities to stakeholders other than shareholders.

The UK government has appointed a Minster for Corporate Social Responsibility as part of the trade portfolio. This has the effect of signalling to business the importance that government attaches to responsible corporate behaviour and providing policy leadership and program coherence. As part of this approach, the UK government also reports on its own vision and progress towards achieving CSR goals.

RECOMMENDATION 2: We recommend that the Australian government appoint a Minister for Corporate Social Responsibility to provide focus and leadership in this area.

An audit of Government activities that support or complement corporate social responsibility efforts should be implemented as an early step. A template for this activity is provided by the USA government which, through the Government Accountability Office, recently completed an audit of federal activities that complement business CSR efforts. This report identified over 50 programs in almost every federal department, yet the government has no co-ordinated approach and consequently sends confusing signals to business. The implications of this report, released in August 2005, are still being considered.

RECOMMENDATION 3: We recommend that the Government undertake an audit of its CSR policies and programs to help define the scope and role of the Minster for Corporate Social Responsibility, including any regulatory or enforcement regimes that may exist or be developed.

In parallel with an audit of government activity to support CSR, we advocate establishment of a multi-stakeholder collaborative process, under Government auspices, that engages business, government, civil society, and mediating institutions in a dialogue aimed at improving CSR. For example, the European Union established a multi-stakeholder forum on CSR to promote transparency and convergence of CSR practice and instruments[4]. Improved transparency and standardisation are important to the advancement of CSR practice so that stakeholders, including investors, can make valid comparisons between the CSR of one company and that of another. The European Union's Multistakeholder Forum on CSR had the effect of improving knowledge about CSR, fostering greater CSR among a range of businesses of all sizes, and fostering development and transparency. This could provide a suitable model for the Australian Government to improve its ability to facilitate greater CSR.

RECOMMENDATION 4: We recommend that the Government establish a multi-stakeholder forum on CSR, linking business, government, civil society and mediating institutions, to facilitate greater knowledge and development of CSR.

[4] See http://europa.eu.int/comm/enterprise/csr/index_en.htm

THE CASE FOR INCREASED SUPPORT OF AS8003

In 2003 Australia produced a Standard for Corporate Social Responsibility, AS8003, that aimed to facilitate a self-regulatory approach to CSR and provide a framework for the development and monitoring of effective CSR. When considered against world's best practice in CSR, we regard it as a providing a foundation for good CSR practice that provides clear guidance to corporations beginning to address CSR, as well as those at a more advanced stage.

The Standard encourages identification of CSR issues, development and implementation of policies and operating procedures for CSR, reporting and independent verification of reports, stakeholder engagement, and education and training in CSR. Corporations at an advanced stage are likely to exceed the requirements of AS8003 and corporations at an early stage can use the standard as a basis for going forward.

Regrettably, the AS8003 has almost no visibility in business. We do not know the extent to which it is being used by business or even if business is aware of it. The AS8003 has no regulatory or certification framework attached to it. Without awareness and encouragement or enforcement, AS8003 is unable to perform its intended role.

Attention to CSR standards at a global level is increasing due to the current work by the International Standards Organisation to develop a global standard for CSR, ISO26000, due for release by 2008[5]. The AS8003 will form an important resource for the development of the global standard. The most recent meeting of the international working group for ISO26000 was attended by 43 ISO member countries, including 21 developing countries. Australia is now poised at a critical juncture whereby it has the opportunity to show leadership and assist many of its neighbours and partners by demonstrating good practice in implementing its CSR standard and providing encouragement for greater CSR.

AS8003 should be given further support through the development of a certification program and associated training and development. This would increase its visibility, attractiveness and usefulness to business, and help ensure the spread of a baseline level of attention to CSR in Australian business.

RECOMMENDATION 5: We recommend that AS8003 be supported through the implementation of a certification program with associated training and development support.

CSR might help in developing Australia's international profile and competitive position in the global market place, increasing its attractiveness as an investment market and partner for regional or international initiatives.

RECOMMENDATION 6: We recommend that Government support further research into the role of CSR in developing Australia's international profile and competitive position in the global market place.

There are clearly numerous ways in which government can provide an enabling environment for CSR. Our submission has briefly canvassed only a few options that we believe would have a significant impact on improving the social responsibility of business. By implementing these suggestions, Government has the ability to demonstrate its leadership in and commitment to CSR, to deliver greater benefits to businesses and the societies in which they operate.

[5] See http://www.iso.org/iso/en/info/Conferences/SRConference/home.htm

For further information:

Dr Leeora Black
Managing Director
Australian Centre for Corporate Social Responsibility
PO Box 2371
Caulfield Junction, VIC 3161
Phone 03 9576 1694
Fax 03 9576 1517

This submission was prepared with assistance and support from:

Wendy Stubbs, Associate, Australian Centre for Corporate Social Responsibility
Wendy Stubbs has held senior management roles at leading global corporations and researched sustainable business models for her doctoral thesis at Monash University.

Paul Hohnen, Principal, Sustainability Strategies (Amsterdam)
Paul Hohnen is a member of the ISO Working Group on Corporate Social Responsibility. Prior to establishing the consultancy, Sustainability Strategies, he was an Australian diplomat to the OECD, a director of Greenpeace International and head of Strategy for the Global Reporting Initiative.

Lauren Chaffey, University of Melbourne BA (Hons) work experience student
Lauren Chaffey is completing an Honours thesis in Corporate Social Responsibility.

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Response to Corporations & Markets Advisory Committee on

Corporate Social Responsibility

Introduction

Hermes is one of the largest pension fund managers in the City of London and is the principal manager of the BT Pension Scheme and the Royal Mail Pension Plan. We also respond to consultations such as this on behalf of the British Coal Staff Superannuation Scheme and some 200 other clients. Hermes has approximately £61 billion under management* and it advises with respect to a further £10 billion. Of the total, around £19 billion is invested in overseas equities in markets including Australia. The beneficiaries of our clients are over 12 million people worldwide who depend on us for at least a part of their financial security in retirement.

Hermes takes a close interest in matters of company law and regulation because they set the context for the exercise of our clients' rights as part owners of the companies in which they invest. We seek to safeguard our clients' current rights and also to enhance the transparency and accountability of companies and their directors to their long-term owners.

By enhancing accountability, we hope to improve efficiency by addressing what economists call the "agency problem". It is our fundamental belief that companies with concerned and involved shareholders are more likely to achieve superior long-term returns than those without. By helping make company directors accountable to company owners for the decisions they make and the actions that they take, we believe that over time we will encourage better decision-making and greater value-creation. We believe that this will benefit our clients, which need long-term real growth to meet their obligations to pension beneficiaries, and it will also make companies and economies as a whole more efficient.

In pursuit of these aims Hermes supports a flexible regime which will:

- encourage company accountability;
- encourage responsible ownership by shareholders and fiduciaries;
- ensure independence of those who audit and monitor company performance; and
- ensure the measures used in reporting performance are relevant for owners.

We welcome the opportunity to respond to this important consultation by the Advisory Committee. Our answers draw on our experience of the development of corporate social responsibility in other markets, primarily the UK. As an investor in public equities, we restrict our comments to companies in that sector.

* As at January 2006

SECTION 1

- **How might corporate social responsibility usefully be described for working purposes**

- **Which approach or combination of approaches to responsible corporate behaviour is most appropriate**

- **What are the incentives or disincentives for a company to conduct its business in a socially responsible manner**

It is Hermes' view that it is for the board of each company to define what corporate social responsibility signifies for them. This decision should be taken within the context of the company's strategic objectives and its overriding obligation to shareholders to create value over the long term. Hermes position is therefore closest to what the advisory committee describes as a commercial approach. We believe it is in the interests of all companies to conduct their business in a socially responsible manner because this is the best way to ensure that business survives and thrives over the long term. The incentive to adopt responsible practices is therefore one of "enlightened self interest". This is *Principle 9* of the Hermes *Principles* which can be found on our website (www.hermes.co.uk).

Adopting such an approach is for many companies an essential part of maintaining a "licence to operate" in a particular area that is, the ability to maintain the goodwill of the community in which it is located so that future development plans are not frustrated. It is also a key part of good risk management. A sound system of internal control will take into account all potential risks, including social, ethical and environmental risks.

We support the approach embodied by the ASX in its *Principles of Good Corporate Governance and Best Practice Recommendations* and believe that Principle 10 together with Principles 3 and 7 ought to serve as useful guidelines to listed companies.

A company is a legal entity which should only act in the interests of its shareholders. The role of the directors is to ensure that this occurs. Therefore, we believe a purely philanthropic approach is unlikely to be appropriate, as it is difficult to see how this could lead to increased shareholder value. Likewise, an ethics-based approach – where directors decide to adopt particular ethical standards without consideration of the impact on shareholder value – does not seem sensible to us. Quite apart from the difficulties of determining which ethical standards are appropriate, it is again difficult to make a link between this position and the ability to increase shareholder value.

- **Do different or additional implications arise depending on the nature or size of the enterprise, for instance:**

  - **the sector or industry in which an organisation operates**

  - **whether a company has international operations**

Clearly, the sector in which a company operates is likely to have a significant bearing on the nature and the size of the risks it faces. An extractives company will face very different challenges to an information technology company, for example. Likewise, the presence and location of any international operations has a major bearing on a company's risk profile particularly if, for example, these operations are in emerging markets located far from the company's headquarters or held via a joint venture. It is for these reasons – among others - that Hermes does not favour mandatory reporting of particular areas but rather an individual approach to each company depending on its particular circumstances. Each company is unique and faces unique challenges.

- **In practice:**

  - **to what extent is corporate decision-making driven by stakeholder concerns**
  - **how do companies differentiate between various categories of stakeholders**
  - **in what ways do companies balance or prioritise competing stakeholder interests, and**
  - **How do companies engage with stakeholders?**

Hermes believes that those responsible for managing a company are in best placed to define the key issues it faces and the most appropriate reaction to these. Whether or not companies approach investors proactively via a 'stakeholder consultation' or responsibility roadshow, Hermes contacts firms where it has concerns about any aspect of their performance. We would expect to be able to discuss such concerns with board level representatives where required.

- **In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company**

From our own perspective as a shareholder, the vast majority of Hermes' assets are passively managed. Where we believe that companies in which we invest are not managing the risks that they face appropriately, we will engage with board members at these companies with the aim of encouraging better risk management. We also have a number of smaller, actively managed portfolios and social responsibility performance is one of the factors that our active fund managers take into account when making investments in these portfolios.

- **Are there any changes that could enhance triple bottom line, sustainability or like reporting; including:**

  - **Increasing the level of clarity and comparability of these reports**

  - **Any suggested changes to external verification of those reports**

  - **Whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s)**

While Hermes would welcome increased levels of clarity in sustainability reporting, we do not believe that mandatory reporting of particular facts or figures is the right way to achieve this. Our concern around mandatory reporting is that companies would tend to view such reporting as a compliance process rather than an opportunity for communication. There is a danger that excessive rule-making might encourage a proscribed, a 'boilerplate' reporting style. Too many of companies' communications with shareholders are already of this nature, and they provide very little in the way of genuinely useful information to investors or to other stakeholders.

In this light we would encourage a loose framework rather than a rule-based approach, which should give rise to an environment where investors could suggest improvements or further disclosures by individual companies. Best practice would therefore develop through a process of dialogue between companies and their shareholders.

Hermes does not have a particular view on external verification. However, where companies choose to adopt this approach, we would hope that the process of gaining verification has helped them in their reporting and management processes.

- **Are there particular issues for small to medium enterprises?**

Were the current requirements for sustainability reporting to be significantly expanded it is likely that this burden would weigh more heavily on SMEs than their larger counterparts. This is a further argument for the loose framework approach so that companies can respond appropriately to the regime in the way which is most suitable to their particular circumstances and financial means..

SECTION 2

- **Whether, or in what circumstances, companies feel constrained by their understanding of the current law on directors' duties in taking into account the interests of particular groups who may be affected, or broader community consideration, when making corporate decisions**

- **If so, is there any useful scope for clarifying the current law in this respect**

- **Does the current law give directors sufficient flexibility to balance long-term and shorter-term considerations in their decision-making**

As indicated above, we believe that the directors' duty always to act in the best interests of the shareholders means that they need to take into account the interests of other stakeholders. The bulk of shareholders – pension schemes and the like – invest for the long term and their interests are not served if the company takes short term advantage of customers, suppliers, employees or its environment. Thus the current articulation of directors' duties captures these issues already and so clarification is necessary. If a change were to be made, we would recommend following the restatement in the UK Company Law Bill.

- **Are any changes needed to the current law regarding the right of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?**

Hermes does not believe that changes to the law are required in this respect

SECTION 3

- **Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties**

Hermes supports the approach that has been adopted in the UK to incorporate "enlightened shareholder benefit" into company law. We believe that a director's primary duty is to the shareholders of the company on whose board he or she sits. A director has the obligation to take other interests into account where these have a bearing on a company's ability to create shareholder value, but not to the detriment of shareholder interests.

- **Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only.**

As in the UK, this change would be only a clarification not a change in the law.

- **If a pluralist approach were to be adopted**

  - **Should directors be permitted to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions, or alternatively**

  - **Should directors be required to take into account their interests of specific classes of stakeholders or the broader community when making corporate decisions**

  - **In either case, what broader interests should be identified**

  - **How might any proposed amendment be implemented and enforced.**

Hermes does not believe that a pluralist approach ought to be adopted.

- **If an elaborated shareholder value benefit approach were to be adopted:**

  - **What form should it take**
  - **Would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments**

  - **How might any proposed amendment be implemented and enforced?**

Hermes would favour the introduction of an enlightened shareholder value benefit approach. We support the model adopted in the UK Company Law Reform Bill and believe that this would be appropriate within the Australian regulatory regime.

SECTION 4

- **Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities.**

- **Are any changes desirable to any other reporting requirements, such as the ASX Listing Rule requirements, the ASX Corporate Governance Principles or relevant accounting standards, to provide more relevant non-financial information to the market.**

- **Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles**

Hermes believes that the ASX *Principles of Good Corporate Governance and Best Practice Recommendations* if properly interpreted are sufficient to ensure that the environmental and social impact of a company's activities is properly disclosed. In particular Principles 3, 7 and 10 appear to provide for all the key disclosures in these areas to be made. We would therefore discourage the Advisory Committee from recommending additional regulation.

Hermes does not believe it would be helpful to specify criteria to assist in comparing narrative disclosures. Aside from the fact that it is difficult for us to imagine what these could usefully be, each company faces a unique set of challenges and has a unique set of issues on which is it appropriate to report. It is preferable in our view for shareholders to engage with companies where they believe their narrative reporting is inadequate to develop a best practice approach.

- **Would an additional environmental or social 'impact' reporting obligation be appropriate and feasible and, if so, how might it be stated?**

We believe that the current principles do already place an obligation on companies to disclose in these areas where these represent material business risks.

SECTION 5

- **To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance.**

- **What lessons might be derived from any experience with voluntary initiatives.**

Hermes believes that shareholders have a key role to play in encouraging companies to adopt responsible business practices but that the most effective encouragement is peer pressure. Market initiatives, such as that adopted by the ASX, are also from our experience extremely successful in bring about changes in corporate behaviour.

Voluntary initiatives may be important where there is a clear void in terms of guidance or where competitive issues make such initiatives appropriate. Companies may also choose to take advantage of voluntary guidelines, such as the Global Reporting Initiative, in preparing their reports. These are available to companies on a global basis.

In our experience market indices have not led to an improvement in standards of behaviour of disclosure as the requirements for inclusion in such indices tend to be extremely broad. Being excluded from such indices, by contrast, can have a substantial reputational impact.

While we have seen a marked increase in corporate interest in social and environmental performance in recent years, we do not have any compelling evidence that the variety of governance and joint government industry initiatives has had a substantial impact on standards of corporate behaviour.

Lend Lease

Lend Lease
Corporation
ABN 57 059 923 465

30 The Bond
30 Hickson Road
Millers Point NSW
2000
Australia

Telephone
02 9277 2631

Facsimile
02 9383 8138

DX 10230 SSE

28 February 2006

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

**RE: Corporations and Markets Advisory Committee (CAMAC)
Inquiry into Corporate Social Responsibility**

Dear Mr Kluver

Lend Lease appreciates the opportunity to make a submission and share its perspective to the CAMAC Inquiry into Corporate Social Responsibility (CSR).

As an Australian publicly listed global real estate company, we recognise CSR is directly linked to ethical conduct, transparency and legal compliance. As we begin to better understand and measure our impacts, we recognise CSR goes beyond profit-making or philanthropy, and should underpin core business strategy, and prudent risk management. We view CSR as a foundation to broaden business opportunities for creating new markets, operational efficiency, effective access to capital, and long-term value that benefits our people, our shareholders, the communities and economies in which we operate.

Community and political reaction to recent corporate collapses have provoked closer scrutiny on how to further reinforce additional CSR obligations, but in our view, additional regulation will not of itself be a panacea for eliminating such future collapses. The appetite for more robust CSR is also a function of other pressure points advocating accountability: market reactions by more sophisticated investment / investor climate; the plurality and visibility of opinion-making interest groups; and a community increasingly empowered in communicating what they expect from companies. They bring to the table a new perspective: that analysis of the traditional balance sheet is no longer a sufficient indicator of a company's performance and that, for a holistic evaluation non-financial elements must also be included.

For Lend Lease Corporation, as a corporate group integrating much of the property supply chain, (design, project management, construction, development management, asset management, asset ownership, wholesale funds management etc), CSR underpins a broader, more complex agenda of sustainability.

We see CSR as part of a 'reframing' of what our business is about, identifying competitive efficiencies, managing risks, looking for ways to innovate to create long term value, through what we are creating and delivering, what we have done well, what we need to do better and what our legacies are for future generations. We have begun our first tentative steps along the sustainability journey by publishing our inaugural Sustainability Report (refer www.lendlease.com.au).

In response to the CAMAC discussion paper, we have identified four main issues summarised as follows:

1. **In a dynamic market environment, balancing competing interests, businesses must have the flexibility to voluntarily determine their own practice of CSR rather than comply with a one-size fits all approach.** Businesses will determine CSR in different ways across the various industry sectors, across various sizes and stages of maturity, and will have to deal with transforming internal management and Board cultures. We believe this is best achieved by allowing broad interpretation of legislation, rather than additional, prescriptive obligations, as:

    a) the compliance cost could be a barrier to entry for new businesses;
    b) it does not incentivise businesses to transcend a compliance culture;
    c) it creates additional regulatory cost burdens that would be passed through to the community as additional costs of doing business; and
    d) it adds administrative complexity in regulatory monitoring and reporting by the regulating Authority.

2. **Extensive legislative obligations from a broad range of State and Commonwealth legislation already exist** – for example environmental, occupational health and safety and Trade Practices, each contemplate the protection of a range of stakeholders which directly and indirectly affect the obligations of directors. A prescriptive regulatory approach starts to create literal interpretation, and enables a 'gaming' of the regulatory regime. Additional regulatory requirements under *Corporations Law* will add further convolution and may not necessarily eliminate behaviour of rogue companies.

3. **We believe in voluntary reporting of non-financial performance.** Current financial reporting only provides a partial insight into the conduct of the organisation. Market forces can provide impetus for

companies to aspire to best practice. The Global Reporting Initiative (GRI) is an example of this, defacto best practice, providing a sustainability reporting framework that is experiencing increased take-up by over 800 companies internationally. We would support greater Australian involvement in the development of relevant sector GRI reporting requirements and would support the government if it was to establish a nationally coordinated forum on this.

4. **More education is required to mainstream CSR**. We advocate targeted education programs as part of professional development toolkit for directors, managers and the financial community generally. For example, education on transparency, ethical conduct and stakeholder engagement, can help shift the traditional mindset of successful corporate performance (in the financial community for example) to reframe successful corporate performance as including broader non-financial measures. Government and industry need to take a community education leadership position on communicating the objectives of CSR to the Australian community.

Conclusion

Lend Lease is keen to understand the Federal Government's position on non-financial reporting frameworks such as GRI, and the interface and or harmonisation with existing legislative and financial reporting standards and frameworks under *Corporations Law*.

We would especially welcome the opportunity to engage in future dialogue with CAMAC in respect of:

1. The interface between voluntary reporting frameworks on non-financial corporate performance (e.g. Global Reporting Initiative) locally and internationally and the current corporate regulatory regime under *Corporations Law*; and

2. The harmonisation between non-financial reporting frameworks and current financial reporting standards under *Corporations Law* to reinforce clarity and comparability in non-financial reporting across businesses.

If you have any questions or require any further information please contact myself or Ms Ro Coroneos, General Manager, Corporate Sustainability Team on 02 9277 2140.

Yours sincerely,

Maria Atkinson

Global Head of Sustainability
Lend Lease Corporation

1 March 2006

Mr John Kluver
Executive Director
Corporations and Markets and Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

Re: Corporate Social Responsibility – Discussion Paper

ANZ appreciates the opportunity to provide comments in response to CAMAC's Discussion Paper on Corporate Social Responsibility.

ANZ has contributed to the current Inquiry of the Parliamentary Joint Committee on Corporations and Financial Services into Corporate Social Responsibility. As the Inquiry's terms of reference are very similar to those assigned to CAMAC, I have attached ANZ's submission to the Parliamentary Committee as ANZ's response to the issues raised in CAMAC's Discussion Paper.

I would also like to elaborate on possible reforms to the directors' duties contained in the Corporations Act, given this is the focus of the CAMAC reference, and update you on ANZ's reporting of its Corporate Responsibility activities.

Directors' Duties

ANZ does not support legislation as a means to encourage directors to take into account the interests of stakeholders and the broader community because:

- corporations currently engaged in strategies or projects with a socio-political purpose are not constrained by the current law in relation to directors' and officers' duties;
- market and social forces are currently driving corporate decision makers to take due consideration of the interests of the organisation's broader stakeholders; and
- reducing Corporate Responsibility (CR) to compliance obligations will encourage a 'compliance approach', thereby diluting the incentive to seek competitive advantage through innovation.

Section 181 of the Corporations Act requires directors and officers to exercise their power and discharge their duties:

- in good faith in the best interests of the corporation; and
- for a proper purpose.

A question to be considered by CAMAC when assessing the need for reform is whether the current law impedes a director's ability to make decisions with a socio-political purpose and which may not immediately maximize shareholder value.

ANZ believes a false dichotomy has developed between the 'best interests of the corporation' and the interests of the company's wider stakeholders. The current primary obligation to act in the best interests of the corporation gives directors sufficient scope to consider broader interests. Indeed, far from restricting a company's ability to give due consideration to the interests of wider stakeholders, it could be argued that the current law already requires it.

Failure to engage all stakeholders can cause multiple risks to a corporation, including:

- **brand risk:** for example, the community backlash against Nike for its use of labour in developing countries under 'sweat shop' conditions developed into an international campaign which in turn had a detrimental impact on Nike's sales volumes;

- **employee risk:** a major challenge for enterprises is the ability to attract and retain quality people and this challenge is compounded if consideration is not given to employee engagement, work/life balance and flexible working arrangements; and

- **regulatory risk:** Governments and regulators listen to community sentiment – failure to respond to community expectations can translate into political and regulatory pressure, potentially affecting the amount of regulation imposed on the company and increasing the cost of compliance.

There is a wide range of social, political and environmental pressures encouraging corporations to act responsibly and responding to these pressures is integral to the organisation's sustainability. It is doubtful whether, in light of these pressures, a director focused solely on the company's short term share price could successfully argue sufficient compliance with the duty to act in the best interests of the corporation.

The social and political pressures which eventually prompted James Hardie to enter into a long-term agreement with the NSW Government and the ACTU to compensate asbestos victims illustrate the consequences of taking too narrow an approach to corporate decision making.

A Bill[1] currently before UK Parliament proposes to introduce into legislation the concept of 'enlightened shareholder value'. If passed, the Bill would for the first time enshrine directors' duties in UK law. The Bill would require directors to promote the success of the company for the benefit of its members as a whole, but would explicitly state that this can only be achieved by taking into account the interests of other stakeholders, as far as they are relevant or reasonably practical.

In ANZ's view, this proposed legislation is no different in practice to the existing duty contained in the Australian Corporations Act. By framing the

[1] Company Law Reform Bill 2005

duty broadly as 'to act in the best interests of the corporation', the current Australian law already reflects the principle of 'enlightened shareholder value'. Courts have also interpreted the duty broadly, allowing directors some discretion to determine what is in the best interests of the corporation[2], leaving plenty of scope to factor in the interests of a wider range of stakeholders.

As well as being unnecessary, ANZ believes legislative intervention could have a detrimental effect to development of CR in Australia. Legislation is at odds with the nature of CR. As recognised by the European Commission[3], CR by definition involves companies 'integrating social and environmental concerns in their business operations and in their interactions with their stakeholders on a *voluntary* basis' (my emphasis).

The true value of CR for a corporation is the recognition of a genuine effort to meet community expectations and the trust that is earned by that effort. This means going beyond basic legal obligations and acting in accordance with what the corporation sees as its social responsibilities. Further, companies can extract greater value from the process by being innovative with the way they engage with the community and focused on relevant, effective measures in areas it can add experience and expertise.

Should CR be transformed into a compliance requirement, many companies will respond with a 'compliance approach'. CR would be associated with companies fulfilling their legal duties rather than genuinely contributing to the community in which they operate in an innovative way. ANZ believes the most effective and sustainable way for a corporation to incorporate CR into what it does everyday is not through threat of legal sanction, but through developing a corporate culture which demonstrates the benefits of effective stakeholder management.

Reporting

Since the submission to the Parliamentary Committee, ANZ has released its first full Corporate Responsibility Report (December 2005) which summarises our performance in serving the interests of all ANZ stakeholders including our shareholders, staff, customers and the community. The 2005 report is included with this letter.

Please do not hesitate to contact Michael Vasta on 03 9273-6332 or at vastam@anz.com to discuss any aspect of this submission.

Yours sincerely

[2] Harlowe's Nominees v Woodside (Lakes Entrance Oil) (1969)

[3] Green Paper, *Promoting a European framework for Corporate Social Responsibility.* Commission of European Communities, p.6

Jane Nash
Head of Government and Regulatory Affairs

Inquiry into Corporate Responsibility

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Parliament of Australia

September 2005

ANZ AND CORPORATE RESPONSIBILITY

ANZ's perspective on the discussion about the responsibilities of corporations is best reflected in the resetting, several years ago, of our mission. This put the organisation on a journey to "humanize" ANZ internally and externally, and created clear aspirations for ANZ's relationships with each of our stakeholder groups:

The Bank with a Human Face
Put our customers first
Perform and grow to create value for our shareholders
Lead and inspire each other
Earn the trust of the community
Breakout, be bold and have the courage to be different

The customer, people and community aspects of the above are most relevant to the inquiry's terms of reference. We illustrate below for the Committee how these aspirations have been put into effect, how ANZ thinks about and acts on its corporate responsibilities and the outcomes we have achieved for all stakeholders through this approach.

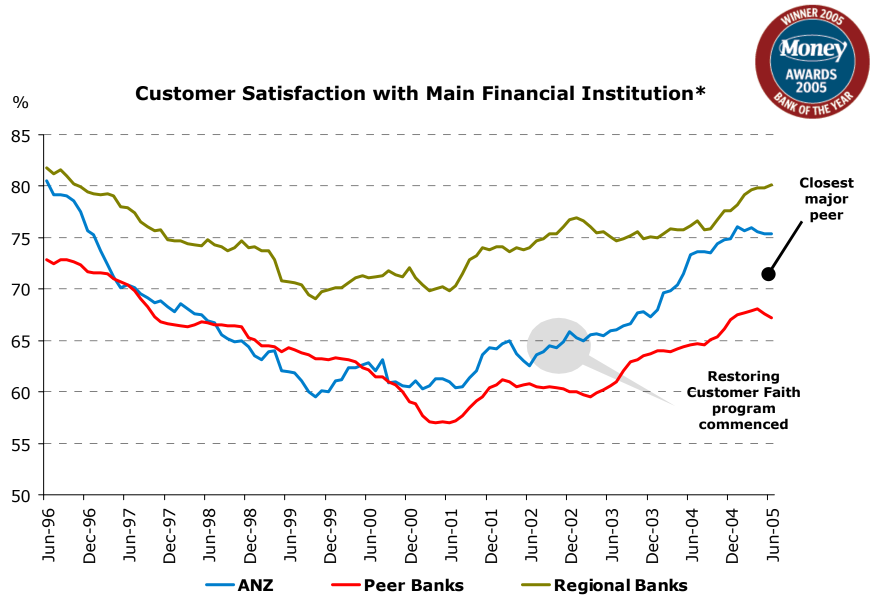
Customers

It is well understood that those who provide superior service and added value to customers generally become the most successful. It is also conventional wisdom that companies with market leadership generally produce the highest long-term shareholder returns. There is therefore real merit in the philosophy of "putting our customers first" and putting this into practice requires real commitment to this agenda. For ANZ this has included:

- A customer charter with specific, measurable commitments to customers that are audited and reported on each year;
- Leading the way in opening rather than closing branches. We have a moratorium on closing branches and this year we have opened 15 branches in Australia, 3 in New Zealand and plan to open an additional 65 in the coming years;
- Adding 3000 mostly customer-facing staff in the past 18 months while others have been reducing staff numbers; and
- Committing to keep our customer contact centre staff here rather than offshoring to a lower cost location, on the basis that customers prefer it that way.

The result of these and other actions is that ANZ now has the most satisfied retail customers of all major banks in Australia. This year, ANZ was also awarded Money Magazine/Cannex Bank of the Year for the sixth year in a row.

Best-regarded major bank for retail customers



* Source: Roy Morgan Research – Main Financial Institution
6 monthly moving average

People

Many forget that it is people who serve customers, create new ideas and who make companies great. Arguably, our people invest more in the company than shareholders. They invest themselves, not just their money. And thus our responsibilities to them are, in turn, perhaps our greatest. How people feel about working in our organisation and how passionate and engaged they are in its agenda, is what makes the difference between good and great companies.

Our people innovate and produce results, and we in turn provide them with opportunity and development. People don't just want a job they want a life. At work they don't just want to be an employee, they want to be a person, bringing their whole self to work, not simply what a stereotypical "boss" might want them to be, defined and boxed. Instead they want to be free and creative. People are searching for fulfillment and meaning from their work.

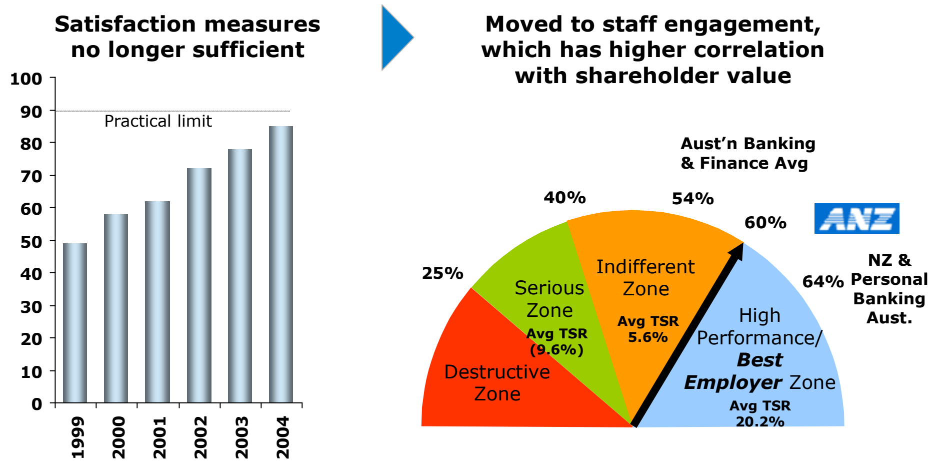
Since our staff members spend much of their working lives with us, if we as employers can't or won't help them on this journey they will find it on their own, or with those companies who will.

Investing in leadership and management is also fundamental, as superior leadership is the scarcest resource in business today. As leaders, our main responsibility is to enhance the capacity of our people to reinvent a new future for the organisation. This requires us to create an environment of opportunity and challenge for our people, enhancing their capacity to produce and create and to stimulate, release and focus the incredible energy that often remains latent.

Thus, ANZ is now probably the largest private sector recruiter of graduates in Australia and the largest investor in enlightened people practices, organisational values and cultural development programs.

As a result of our philosophy on people and the actions that support it, ANZ has 87% staff satisfaction across its 32,000 people, together with the highest staff engagement of all major companies in Australia.

Highest staff engagement of major Australian companies



Satisfaction measures no longer sufficient

Moved to staff engagement, which has higher correlation with shareholder value

Note: Average Total Share Holder Returns (TSR) 1999-02 avg
Source: Hewitt Associates, August 2005

Community

Companies are not "islands" that exist separate from the communities within which they operate. Successful companies understand their customers, their staff and their communities. They understand what their communities expect, admire and what won't be tolerated.

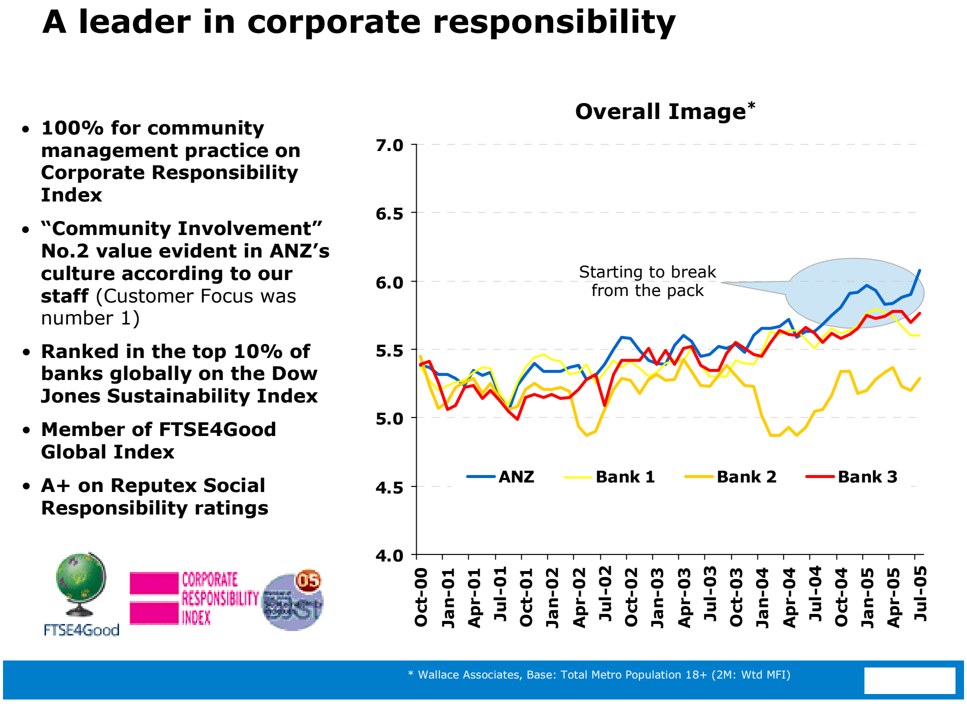
One of the reasons for a company's long-term success is the skill with which it engages with and invests in the community. Of course it is from the community that our customers come, our staff live and from where our governments are elected. When the community speaks, governments listen. This can affect the amount of regulation and the cost of compliance, but can also ultimately lead to the demise of a firm.

There are of course boundaries on the extent to which we should invest in the community. As the owners of public companies, shareholders have a legitimate right to ensure their money is being invested properly in their interests. Money spent on the community is an investment and all investments are with the purpose of generating a future revenue stream.

In order to justify such investment, it means ANZ needs to ensure some congruity between our social responsibilities and our shareholders interests. If we stretch the link too far, it is natural for shareholders to voice their concern. If we don't invest at all, we are likely to damage the sustainability of our business. We need to find the balance that satisfies the potentially conflicting needs of stakeholders.

Accordingly, for example, it is easier for us to justify community spending in areas that fit with the nature of our business and where there is proximity to our core business. It becomes difficult to justify spending where there is no discernable link. As a bank, we deal with the investing of customers' deposits, in lending to customers and in handling customers' transactions. Therefore it is easier for our shareholders to understand our social investments where they are concerned with financial issues in the community such as financial understanding, money management and savings.

ANZ's community programs, particularly those addressing the issues of financial literacy and inclusion are recognised as leading practice and we are emerging as the best-regarded major bank in Australia.



A leader in corporate responsibility

- **100% for community management practice on Corporate Responsibility Index**
- **"Community Involvement" No.2 value evident in ANZ's culture according to our staff** (Customer Focus was number 1)
- **Ranked in the top 10% of banks globally on the Dow Jones Sustainability Index**
- **Member of FTSE4Good Global Index**
- **A+ on Reputex Social Responsibility ratings**

Overall Image*

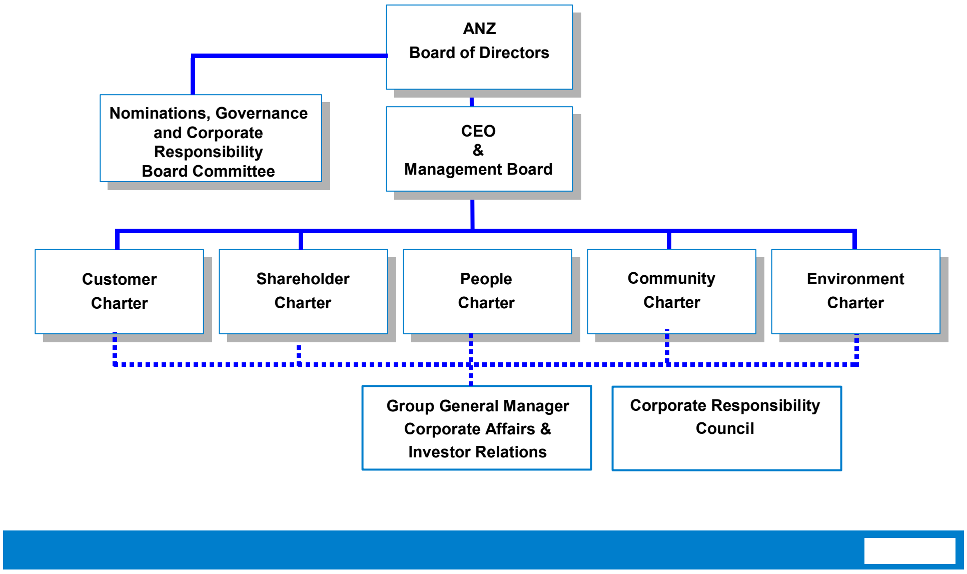
* Wallace Associates, Base: Total Metro Population 18+ (2M: Wtd MFI)

Future of corporate responsibility

Australian companies are becoming increasingly aware of the social, political and environmental context in which they operate and of the importance of responding to the expectations of all stakeholders. Larger corporations are under more pressure to be effectively engaged with the community to remain a successful member of that community in the long term.

ANZ anticipates that in coming years corporate responsibility (CR) will become integral to the way a successful, energetic company behaves every day as part of the way it does business. The ANZ Board's recent decision to explicitly expand the brief of its Corporate Governance Committee to include Corporate Responsibility[4]is strong evidence that this change is well underway at ANZ.

Corporate responsibility governance at ANZ


ANZ
Board of Directors
Nominations, Governance and Corporate Responsibility Board Committee
CEO & Management Board
Customer Charter
Shareholder Charter
People Charter
Community Charter
Environment Charter
Group General Manager Corporate Affairs & Investor Relations
Corporate Responsibility Council

[4] Committee Charter attached.

THE INQUIRY'S TERMS OF REFERENCE

ANZ's response to the Committee's terms of reference can be inferred from the remarks above, however, to assist the Committee we also below respond directly to the following questions:

1. Do organisational decision makers in corporations take into account the interests of stakeholders (other than shareholders) and the broader community and should they?
2. Should the law, particularly the Corporations Act, be amended to encourage incorporated entities or directors to have regard for the interests of stakeholders and the broader community?
3. Should the Corporations Act or other legislation require corporations to report on the social and environmental impact of their activities?
4. What alternative regulatory, legislative or other policy approaches could be adopted in Australia?

1. Do organisational decision makers in corporations take into account the interests of stakeholders (other than shareholders) and the broader community and should they?

ANZ has chosen to enshrine its commitment to corporate responsibility in part of its corporate governance structure to ensure CR activities are incorporated into ANZ's overall business performance and that its CR objectives are appropriately established and monitored on an ongoing basis. The ANZ Nominations, Governance, and Corporate Responsibility Committee has recently been charged with the role of:

- reviewing and monitoring the performance of ANZ's CR strategies and commitments; and
- making recommendations to the Board about ANZ's contribution to society and the interests of ANZ's stakeholders, including shareholders, people, customers and the community and the impact of ANZ's activities on the environment.

ANZ has also amended the ANZ Board Charter, to formalise the responsibility of board members to have regard to ANZ's corporate responsibility objectives and the interests all stakeholders. Under the Charter, Directors are required to serve the interests of shareholders, and act in a way that also acknowledges the legitimate interests of staff, customers, the community and the environment.

2. Should the law, particularly the Corporations Act, be amended to encourage incorporated entities or directors to have regard for the interests of stakeholders and the broader community?

ANZ believes there is sufficient flexibility in the current law to allow decision makers to consider the interests of all stakeholders. The current legislative requirement for directors to act in the 'best interests of the corporation' is consistent with giving due consideration to other stakeholders and the wider community.

There are already social and market forces in place, as discussed above, which make it an imperative for companies to consider the interests of all of their stakeholders in order for their business to remain sustainable over the longer term.

Below we illustrate the existence and impact of these forces by reference to some of ANZ's existing programs. ANZ also believes that the form of reporting on CR activities should be allowed to develop broadly in line with market expectations – each corporation should be free to tailor its reporting to the needs and expectations of its own stakeholders. Government could assist by encouraging and recognising best practice.

The following sections will illustrate these points by reference to some ANZ programs and will explain the types of (non-legislative) social, political and environmental factors that have led ANZ to its position

2.2 Customer initiatives

A company is obviously not sustainable if it does not demonstrate a sufficient commitment to the interests of its customers. There is an undeniable link between protecting the interests of this group of stakeholders and the 'best interests of the corporation'.

ANZ has put into practice the philosophy of 'putting our customers first' by amongst other things establishing a Customer Charter – the only major bank in Australia to do so. The Charter was introduced in its first form in October 2001 and contains promises relating to:

- simple accounts, fees and charges
- simple, fast account opening
- quick, convenient branch banking
- 24-hour, 7-day accessibility
- fast, efficient phone service
- respect for personal information and privacy
- helping customers understand our communication
- swift resolution of complaints
- building relationships with the community
- accountability through an independent audit

Progress on the Charter is reported annually and the promises are constantly reviewed to ensure they remain relevant to the changing expectations of our stakeholders, including our customers and the broader community.

ANZ has also responded to strong customer and community sentiment in relation to access to banking services in remote Australia by placing a moratorium on closing branches in rural and regional areas. This promise was made in 1998 and remains today.

2.3 Employee engagement

ANZ is acutely aware of the importance of investing in what is arguably its greatest resource – its staff. This investment is important to the overall sustainability of the organisation as it ensures:

- current employees are fulfilled and engaged with the values of the organisation and therefore productive; and
- ANZ remains attractive to skilled people as a place of work in a competitive employment market.

ANZ has taken a number of steps to achieve these objectives. The first is to encourage staff to identify with ANZ's values, which are to:

- put customers first;
- perform and grow to create value for our shareholders;

- lead and inspire each other;
- earn the trust of the community; and
- breakout, be bold and have the courage to be different.

Over 20,000 ANZ staff have participated in ANZ's Breakout cultural development program to date. The program includes workshops to help staff apply values-based decision-making and effectively balance the competing needs of staff, shareholders, customers and the community in their roles and activities. ANZ is extending the program to 7000 branch staff over the next 18 months.

A key measure of ANZ's progress in this area is the annual ANZ Values Assessment – a survey which asks ANZ's senior leaders and a random sample of staff from across the organisation to select their top 10 personal values, as well as the current and desired values, to describe ANZ's culture. In 2000, staff nominated 'cost reduction' as ANZ's most important value. In the 2004/5 survey, this had changed to 'customer focus', followed by 'community involvement'. This demonstrates the progress of ANZ's culture transformation program, especially considering 'community involvement' ranked last in the list of ANZ values in 2001 and was not even deemed to be present in 2000.

ANZ has also adopted a number of innovative workplace policies designed to create flexible working conditions responsive to staff needs at various stages of their lives; and encourage staff to maintain an appropriate 'work/life balance'. These measures include:

- two forms of paid parental leave: parental leave assistance of 12 weeks' pay which can be paid either as a lump sum up front or in installments (over 12 weeks or at half pay over 24 weeks). ANZ also provides co-parents assistance which provides one week paid assistance for co-parents immediately following the birth or placement of an adopted child;
- the ability for full time employees to apply to work part time either during pregnancy or following paternal leave. These employees also retain the right to return to full-time employment at the end of this period;
- a partnership with ABC Learning Centres to build and operate childcare services for ANZ staff in metropolitan areas around Australia. The arrangement offers ANZ employees priority enrolment and the option of salary packaging or sacrificing the whole or part of the cost of the child care fees;
- providing staff with ongoing support and contact before, during and after taking leave from the workplace to care for a child;
- support for flexible working arrangements including part time work, working remotely and job-sharing;
- providing facilities for nursing mothers;
- providing "Financial Fitness" sessions covering financial management essentials for our people
- Lifestyle Leave program, which enables staff to tailor their salary over a year to provide up to an additional four weeks leave for any purpose;
- ANZ Career Break, which offers employees the opportunity to take between six months and five years of unpaid leave to pursue personal development or family commitments; and
- ANZ's new Part Time Work: Career Extension policy guarantees those Australian staff aged 55 and over who wish to work part-time, instead

of full-time, the right to do so. This can be in their existing role or elsewhere at ANZ.

ANZ believes these strategies have had a positive effect on levels of staff satisfaction. This is evidenced by an annual survey conducted by ANZ which shows the rate of overall employee satisfaction has grown from 49% in 1999, when the survey was first conducted, to a current record high rate of 87%.

This year ANZ has also been recognised as having the most engaged workforce of all major Australian companies (2005 Hewitt Best Employers survey) and as the leading major Australian organisation for the Advancement of Women by the Equal Opportunity for Women in the Workplace Agency (EOWA) Business Achievement Awards.

2.4 Financial literacy and inclusion

ANZ has implemented a series of initiatives and programs designed to address two of the major social issues facing the financial services industry - financial literacy and financial exclusion.

In 2003, ANZ conducted the first national survey of Australian adult financial literacy, which provided valuable information on the size and nature of the financial literacy issue and areas for action. The research showed that while most Australians have a reasonable level of financial literacy, there is a strong correlation between financial literacy and socio-economic status. The lowest levels of financial literacy were associated with low education levels, unemployment, low incomes, those with low savings, single people and people at both extremes of the age profile (18-24 year olds and those aged 70 and over). ANZ has committed to undertaking this research every two years and the next round of results is due to be released in late 2005.

ANZ has defined 'financial exclusion' as the lack of access by certain consumers to appropriate low-cost, fair and safe financial products and services from mainstream providers where this lack of access causes a level of harm to the consumer. This definition emerged from research commissioned by ANZ and conducted by Chant Link and Associates in 2004. The research examined the extent to which people have difficulty accessing 'mainstream' banking products and services. Conducted over 12 months in 2004, the research indicated that up to 120,000 Australians are struggling to gain access to appropriate low-cost, fair and safe financial services and nearly one million Australians have only basic access to financial services. Many of these are unemployed, in poverty, disabled or Indigenous Australians.

ANZ has used its research described above to design strategies to improve the financial literacy of consumers identified as having financial management difficulties. This includes development and implementation of a range of innovative community programs in partnership with government, regulators and community organisations. Examples of these are described below.

2.4.1 MoneyMinded

ANZ has funded the development of MoneyMinded, Australia's first comprehensive adult financial literacy program, to help people, particularly low-income earners and those facing financial hardship, develop the knowledge, skills and confidence to increase their personal financial well-being. It covers 17 workshops including planning and saving, understanding paperwork and living with debt. MoneyMinded is delivered by financial counsellors and community educators and was developed by the Centre for Learning Innovation in the NSW Department of Education and Training with input from the Australian Financial Counselling and Credit Reform Association (AFFCRA), ASIC and ANZ. MoneyMinded is not ANZ branded and does not promote any ANZ products or services.

The MoneyMinded program has been provided to more than 2000 consumers since its launch in 2004. Our goal is for MoneyMinded to reach 100,000 "at risk" people over the next five years.

2.4.2 Saver Plus

Saver Plus is a matched-savings and financial literacy program aimed at supporting low-income families to develop a long term savings habit, improve their financial knowledge and save for their children's education. As part of the program, ANZ rewards the efforts of participants who save by matching every $1 saved with an additional $2 up to a maximum matched amount of $2000. Participants agree to use the savings towards purchases related to their children's educational needs, like school uniforms, stationery and personal computers.

The costs of the program are met by ANZ while the program is delivered through community partners, namely the Brotherhood of St Laurence, which led the program as ANZ's principal partner, Berry Street Victoria and The Benevolent Society. The Smith Family recently became a partner, delivering the program in Queensland. In 2004, 260 families participated in the pilot program together saving $240,500. ANZ matched these savings with a further $481,000. In 2005 451 families are participating in Saver Plus.

Saver Plus was recognised in the 2004 Prime Minister's Awards for Excellence in Community Business Partnerships, winning the Victoria Large Business Award category.

2.4.3 MoneyBusiness

ANZ has recently launched MoneyBusiness in conjunction with the Federal Government through the Department of Family and Community Services. MoneyBusiness is a money management skills and savings program designed to assist Indigenous communities build financial literacy, budgeting, bill paying and savings skills. It is partly a response to ANZ research into financial literacy and financial exclusion which reinforced the position of Indigenous people as among the most disadvantaged groups in Australia with lower levels of financial literacy and poor access to appropriate, fair and safe financial products.

ANZ's contribution includes funding of $1 million over three years to adapt MoneyMinded for use by Indigenous communities and to roll out the Saver Plus program to families involved with MoneyBusiness. The program will be provided by trained local Indigenous people.

The program was launched on 31 July 2005 and will be piloted in six sites in the Northern Territory and Western Australia over a three-year period.

2.4.4 Financial Inclusion

The consequence of 'financial exclusion' is that some Australians are using 'unsafe' and costly options, including credit through loan sharks and 'pay day' lenders. In response, ANZ committed to spending $3 million to expand its current programs to improve financial inclusion through:

- a new loans program tailored to the needs of people on low incomes who are currently using fringe credit providers such as 'pay day' lenders;
- assisting wider delivery of the MoneyMinded program;
- microfinance programs including funding, financial literacy education, mentoring and support to facilitate the development of Indigenous businesses, delivered in partnership with credit unions; and
- expansion of Saver Plus to Indigenous communities.

2.4.5 Customer initiatives

Consistent with ANZ's broad commitment to financial literacy and inclusion, ANZ has taken a number of steps to develop a simple range of mainstream banking products for a variety of different customers. In 2002, ANZ streamlined its Access transaction accounts in response to customer feedback that our product range was too complex. The result is two transaction accounts:

- Access Advantage: an 'all you can eat account' providing an unlimited number of ANZ transactions for $5 per month. This product is marketed to customers who make a high number of transactions per month; and
- Access Select: a 'pay as you go account' with no monthly fee and up to six free ANZ transactions per month.

In 2002 ANZ also introduced a bank account designed specifically for those who receive Government benefit payments. ANZ Access Basic provides eligible customers with free day-to-day transactions through all ANZ channels and no monthly account service fee. For customers over the age of 60, ANZ waives the monthly service fee on Access Advantage and offers Access Deeming accounts, which pay interest at a rate set by the Government to social security and Veterans Affairs pensions.

ANZ has produced brochures and information for customers on key financial issues. *Kickstart your financial fitness* is designed to help ANZ staff assist customers and contains practical information on the basics of money management - including tips on saving, managing debt and credit, investing, retirement planning and protecting assets. ANZ has also produced education material on how to use and manage credit. The *How credit works* website (www.howcreditworks.com.au) and *Understanding credit card interest* brochure provide information on the nature of credit, how to manage it and the responsibilities of customer and credit provider.

2.5 Environment

ANZ has established an Environment Charter, strategy and internal responsibilities for reducing the impact of our operations and business activities on the environment. This approach is outlined in ANZ's Environment Charter[5], which was launched in July this year following consultation with our people, customers and environmental organisations.

Our aim is to align ANZ's environmental performance with our commitment to make a sustainable contribution to society and protect ANZ from the brand damage that would be caused if its operations or lending practices were found to have an adverse effect on the environment.
The strategy focuses on the following areas:

2.5.1 Customer use/application of ANZ products and services

- Providing an environmental and social issues screen of clients and transactions for our Institutional business. This allows key social and environmental risks to be identified and addressed in the credit process.

- Ensuring environmental and social considerations are effectively integrated into ANZ's lending policies and decision-making principles and frameworks.

- Building broad staff awareness and understanding of the business rationale for environmental and social issues screening.

2.5.2 Conduct of our business operations (environmental footprint)

- ANZ has in place programs and targets to reduce the impact of our operations on the environment. These focus on:
  - Reducing electricity consumption by 10% compared to 2003.
  - Reducing office paper consumption by 5% compared to 2004.
  - Increasing recycling and reducing waste to landfill by more than 10% compared to 2004.
  - Enhancing our existing procurement policies and practices to address environmental risks and opportunities in our supply chain.

2.5.3 Design and distribution of products and services

- As part of its broad environment strategy, ANZ also supports a range of corporate and institutional clients and partners involved in projects with specific environmental value.
  - For example ANZ has formed an alliance with Visy Industries to provide additional funding and advice for Australian irrigators to install water-efficient practices and systems. The program has been trialled in the Murrumbidgee region and results from the trial will be evaluated for the design of a national system.
  - ANZ's Environment Charter commits ANZ to providing new products and services designed to help our customers and clients improve their environmental performance.

[5] ANZ Environment Charter attached

- We have conducted a pilot to assess the market for a 'green' mortgage offering in association with not-for-profit organisation easybeinggreen.
- Our ANZ Markets team has established trading capability for Renewable Energy Certificates and is the first bank to be transacting Gas Abatement Certificates.
- ANZ has joined a number of consortia (with BP Solar) and submitted expressions of interest to the Australian Government's Solar Cities Program (subsidies and grants).

ANZ is also working with key stakeholders and community groups to ensure its strategies remain relevant to community expectations and are effective in improving environmental performance. To this end, ANZ participates in key national and international initiatives including the United Nations Environment Program Finance Initiative (UNEP-FI), the Federal Government's Greenhouse Challenge Program and the Carbon Disclosure Project. ANZ is also a founding member of eTree, an initiative of Computershare and Landcare Australia which facilitates the donation of $2 toward environmental restoration programs for every shareholder who chooses via the eTree website to receive their shareholder communications electronically.

3. Should the Corporations Act or other legislation require corporations to report on the social and environmental impact of their activities?

ANZ believes it is preferable to allow innovation to shape reporting standards over time rather than introduce legislation that attempts to mandate format and timing of reporting. The experience in more developed CR markets, like the mining sector, is for best practice corporations to produce two to three 'landmark' annual social and environmental reports and then move to 'real time' reporting which is usually available online and is updated more frequently[6]. ANZ believes a corporation should be free to adapt its reporting on CR in line with emerging best practice, its own CR programs and the changing needs of its own stakeholders. This is in the best interests of the reporting corporation and the audience of the reports.

ANZ produced its first separate social and environmental report in 2004. This document was intended to serve as a baseline report, providing the market with greater transparency about ANZ's programs, ANZ's performance in this area and the outcomes that have been achieved to date. ANZ is currently producing a full CR report for 2005, due for release in December 2005. A copy of the 2004 report is included with this submission.

4. What alternative regulatory, legislative or other policy approaches could be adopted in Australia?

In the absence of a market failure, ANZ believes the most appropriate role for Government in this area is to:

- encourage discussion and debate of the issues, including facilitating the exchange by corporations of their experience of and good practice in CR; and
- promote 'best practice' and innovation by investing in and publishing research into the contribution of CR to corporate success.

[6] Burns, Wayne: Trends in Social and Environmental Reporting among Fortune 500 Companies' (2004) 14(1) *Corporate Public Affairs* 9, p 9-10.

This approach is consistent with the conclusions of the European Commission's consultation with industry on CR in 2001 and 2002. Respondent organisations to this consultation identified the importance of the exchange of experience and good practice in CR between businesses. ANZ believes such an exchange assists businesses to become familiar with the concept of CR and benchmark their own practices against those of other businesses, especially industry sector leaders.

ANZ also sees a role for the Government to ensure the credibility and rigour of published CR benchmarks and indices. This will become increasingly important as the community's expectations that companies' act in a socially and environmentally responsible manner grow and as companies are to a greater extent judged by customers, employees, investors and the broader community by their performance against these established benchmarks.
ANZ believes it is important for CR rating organisations to apply transparent and consistent rating criteria focused on governance, policy, compliance and, most importantly, performance and outcomes. Measures should also be taken to ensure any conflicts of interests of index operators are appropriately disclosed and managed.

SUMMARY

CR involves companies integrating social and environmental concerns in their business operations and in their interactions with their stakeholders on a *voluntary* basis .[7]
The true value of CR for a corporation is the recognition of a genuine effort to meet community expectations and the trust that is earned by that effort. This means going beyond basic legal obligations and acting in accordance with what the corporations sees as its social responsibilities. Further, companies can extract greater value from the process by being innovative in the way they engage with the community and focused on relevant, effective measures in areas it can add experience and expertise.
Should CR be transformed into a compliance requirement, many companies will respond with a 'compliance approach'. CR could be associated with companies fulfilling their legal duties rather than genuinely contributing to the community in which they operate in an innovative way. ANZ believes the most effective and sustainable way for a corporation to incorporate CR into what it does everyday is not through threat of legal sanction, but through developing a corporate culture which recognises and demonstrates the benefits of effective stakeholder enagement.

[7] Green Paper, *Promoting a European framework for Corporate Social Responsibility.* Commission of European Communities, p.6

Submission from Juliette Overland
Department of Business Law
Division of Law, Macquarie University

1 March 2006

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001
By email: john.kluver@camac.gov.au

Dear Sir

DISCUSSION PAPER ON CORPORATE SOCIAL RESPONSIBILITY

Thank you for the opportunity to make a submission on the Corporations and Markets Advisory Committee Discussion Paper November 2005 on Corporate Social Responsibility.

My submission relates to the following issues raised in the discussion paper:

(a) *Paragraph 1.5:*

(i) *What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?*

(b) *Paragraph 2.7:*

(i) *Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?*

(c) *Paragraph 3.4:*

(i) *Should the Corporations Act be revised 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?*

(ii) *Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

(iii) Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?

(d) Paragraph 4.8:

(i) Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Summary of submission

In summary, my submission is that companies have an incentive to act in a socially responsible manner in order to avoid negative publicity, public outrage and condemnation, investor avoidance and a negative impact on their share price. Company directors are entitled to take into account the interest of stakeholders other than existing shareholders when exercising their duty to act in "the best interests of the corporation" and in certain circumstances may be obliged to do so. Acting socially responsibly is likely to result in positive publicity; public approval, endorsement and goodwill; investor confidence and demand; and resulting positive impact on the company share price. Thus it may be in the best interests of the corporation to act socially responsibly. Some minor amendment to the Corporations Act may be necessary for the purpose of clarifying this position. Existing ASX reporting requirements on the social and environmental impact of a company's activities are sufficient, but if any further reporting requirements were to be imposed, the ASX *Principles of Good Corporate Governance and Best Practice Recommendations* provide an appropriate framework.

(a) Paragraph 1.5:

(i) What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

A strong incentive for companies to conduct their business in a socially responsible manner is the prospect of unfavourable publicity resulting from socially irresponsible behaviour. Even companies which are inclined to narrowly focus on achieving short-term benefits and profits for shareholders cannot afford to ignore the interests of other stakeholders.

The case of James Hardie is a good illustration of this point. As is well known, James Hardie sought to minimize its potential exposure to victims of asbestosis who would otherwise have had the right to claim compensation for injury and loss, by relocating overseas, using corporate quarantining and underfunding an established claim fund. The resulting publicity, public outcry and damage to James Hardie's reputation and share price meant that it was essentially forced to enter into negotiations resulting in new arrangements aimed at providing proper compensation for the asbestosis victims.

The recent successes of "ethical investments" also illustrate the desire of sectors of the community to avoid investing in companies which are socially irresponsible.

Accordingly, there is an incentive for companies to act in a socially responsible manner in order to limit:

(i) negative publicity;
(ii) public outrage and condemnation;
(iii) investor avoidance; and
(iv) resulting negative impacts on the company share price.

Conversely, the benefits of acting socially responsibly are likely to be:

(i) positive publicity;
(ii) public approval, endorsement and goodwill;
(iii) investor confidence and demand; and
(iv) resulting positive impacts on the company share price.

(b) Paragraph 2.7:

(i) Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?

It is a fallacy that directors are obliged to focus only on the interests of existing shareholders of a company, with short-term considerations outweighing those more relevant to the long-term. Whilst the duty to act in "the best interests of the company"[1] requires directors to consider the interests of the company's shareholders as a whole,[2] the interests of other stakeholders have always been relevant – in particular, the interests of creditors of the company must be given appropriate consideration in certain circumstances.[3] It is also clear that directors may act in a manner which is considered to be in the best interests of the company even though it may not be in the short-term interests of existing shareholders.[4] Overall, directors have flexibility to consider and balance short-term and long-term considerations when exercising their powers, so long as any decision that is made is in "the best interests of the company."[5]

As noted above, a failure to act socially responsibly can have a significant impact on a corporation's fortunes, with the risk of adverse publicity, public outrage, and investor avoidance. I suggest that this actually obliges directors properly taking into account "the best interests of the company", to consider the interests of other stakeholders and the

[1] See s181(1) *Corporations Act* 2001 (Cth).

[2] See for example, *Greenhalgh v Ardene Cinemas Ltd* [1951] Ch 286.

[3] For example, if the company is proposing to engage in a share buy-back or capital reduction, or if the company is in financial difficulty.

[4] See *Darvall v North Sydney Brick & Tile Co Ltd* (1988) 6 ACLC 154.

[5] For further academic discussion of this issue, see S Deakin, "The Coming Transformation of Shareholder Value" (2005) 13 *Corporate Governance: An International Review* 11; J McConvill, "Directors' Duties to Stakeholders: A Reform Proposal Based on Three False Assumptions" (2005) 15 Australian Journal of Corporate Law 88.

potential impact upon the company of socially irresponsible behaviour. Directors who ignore the interests of other stakeholders now do so at their peril.

(c) Paragraph 3.4:

(i) Should the Corporations Act be revised 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?

As is noted above, company directors are entitled to take into account the interests of stakeholders other than existing shareholders. The balancing act which is therefore necessitated when weighing up the often competing interests of different shareholders, does not readily lend itself to prescriptive rules and must lie within the discretion of directors. At most, to avoid the consequences of a mistaken belief that the interests of existing shareholders are always paramount, s181 Corporations Act could be amended to incorporate new inclusive provisions which are essentially "for the avoidance of doubt":

> *s181(3) A director or other officer of a corporation may take into account the interests of stakeholders other than the existing members of the corporation when determining whether an exercise of powers and discharge of duties is in the best interests of the corporation.*
>
> *s181(4) Stakeholders of a corporation include existing shareholders, potential future shareholders, creditors of the corporation, employees of the corporation, customers and suppliers of the corporation, the environment and the broader community.*

(ii) Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

As noted above, the balancing act which directors must undertake when weighing up the competing considerations of various stakeholders does not easily lend itself to prescriptive rules. So long as directors are bound to act in the best interests of the corporation and it is clear that the best interests of the corporation can include interests of stakeholders other than the existing shareholders, it is not necessary or desirable to place additional obligations on directors in this regard.

(iii) Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?

The amendment I have proposed to the Corporations Law, as set out above, is intended to be a clarification.

(d) Paragraph 4.8:

(i) Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Australian companies listed on the Australian Stock Exchange are already subject to reporting requirements which can and do address the social and environmental impact of their activities. The ASX *Principles of Good Corporate Governance and Best Practice Recommendations* set outs 10 good corporate governance principles, of which principle 10 provides that listed companies need to "recognize legal and other obligations to all legitimate stakeholders." Listed companies are obliged to establish and disclose a Code of Conduct to guide compliance with those obligations, or to explain why they have not done so, in the company's annual report. The suggested content of the code includes information about the company's responsibilities to shareholders and the financial community generally; responsibilities to clients, customers and consumers; employment practices; and responsibilities to the community.

Due to the obligation on listed companies to act in accordance with these recommendations or explain why they have not done so, there is little option but to comply.[6] Accordingly, it is not necessary to impose any further reporting obligations on listed companies. If it was considered desirable to impose any further reporting obligations more specially related to these issues, the ASX recommendations would provide a useful framework within which that could occur.

Thank you for the opportunity to make a submission on the discussion paper.

Yours sincerely

Juliette Overland
Department of Business Law
Division of Law
Macquarie University
Ph: +612 9850 7069
Fax: +612 9850 9952
Email: juliette.overland@law.mq.edu.au

[6] See further J McConvill and J Bingham, "Comply or Comply: The Illusion of Voluntary Corporate Governance in Australia" (2004) 22 Company and Securities Law Journal 208.

QBE Insurance Group

QBE INSURANCE GROUP LIMITED
ABN 28 008 485 014

Head Office
82 Pitt Street
Sydney NSW 2000
AUSTRALIA

Postal Address
GPO Box 82
Sydney NSW 2001
AUSTRALIA

Telephone: +61 (2) 9375 4444
Facsimile: +61 (2) 9231 6104
DX 10171 Sydney Stock Exchange

2 March 2006

Mr J Kluver
Executive Director
Corporations and Markets
Advisory Committee
Level 16, 60 Margaret Street,
SYDNEY NSW 2000

Dear Mr Kluver

Corporate Social Responsibility

We refer to CAMAC's discussion paper in relation to Corporate Social Responsibility (CSR) and welcome the opportunity to respond to the issues raised in the paper.

We also note the submission from Chartered Secretaries Australia (CSA) dated 24 February 2006, and in general, QBE supports CSA's position as detailed in its response.

QBE acknowledges the importance for all corporations to be responsible corporate citizens in carrying out their day to day operations and decision making. We believe this responsibility exists as a result of common law and statutory requirements, together with the cultural framework within individual corporations. As such, we do not believe that CSR is a concept that can be imposed on corporations. It is more than a compliance issue.

In considering the best interests of the corporation, there appears to be a misconception that this will always be predicated on what is best for shareholders. It is true that directors have a duty under sec 181(1)(a) of the Corporations Act to exercise their powers and discharge their duties in good faith in the best interests of the corporation. However, this does not mean at the expense of or detriment to other stakeholders to that relationship.

Shareholders would expect their company directors and management to conduct the affairs of the company in a socially responsible manner. It is important to remember, that often, shareholders may also be members of the group named 'other stakeholders' and therefore the concepts of CSR and the best interests of other stakeholders include shareholders.

We believe any suggestion that a corporation may ignore its social responsibilities in order to ensure shareholder returns is flawed, as the two issues are not mutually exclusive, particularly in the current corporate environment where companies are under their greatest ever level of scrutiny, both from a prudential and public perception perspective.

As such, QBE does not believe that further statutory reforms are required, either in the form of reporting or other standards, in order for directors to understand their role in balancing the interest of the corporation and it shareholders, with those of the other stakeholders.

We would be pleased to assist you with any further information you may require. If you have any questions, please do not hesitate to call either Peter Smiles on (02) 9375 4322 or me on (02) 9375-4422.

Yours sincerely

Duncan Ramsay
General Counsel and Company Secretary
Direct: +61 2 9375-4422
Fax: +61 2 9231-6104
Email: duncan.ramsay@qbe.com

QBE INSURANCE GROUP LIMITED
ABN 28 008 485 014

Head Office
82 Pitt Street
Sydney NSW 2000
AUSTRALIA

Postal Address
GPO Box 82
Sydney NSW 2001
AUSTRALIA

Telephone: +61 (2) 9375 4444
Facsimile: +61 (2) 9231 6104
DX 10171 Sydney Stock Exchange

1 May 2006

Mr J Kluver
Executive Director
Corporations and Markets
Advisory Committee
Level 16, 60 Margaret Street,
SYDNEY NSW 2000

Dear Mr Kluver

Corporate Social Responsibility

We refer to our letter dated 2 March 2006.

Further to our earlier comments, we support the suggestion in section 4.3 of the Corporate and Financial Services Regulation Review Consultation Paper released on 7 April 2006 in relation to extending the Business Judgment Rule.

Our support relates to any obligation a director or officer has under the Corporations Act, where that director or officer has exercised their powers and discharged their duties with the care and diligence of a reasonable person.

We believe that such an extension of the Business Judgement Rule would allow directors and officers to have appropriate regard to the interests of the company, its shareholders and other stakeholders without the fear of being held in breach of their duties.

We would be pleased to assist you with any further information you may require. If you have any questions, please do not hesitate to call either Peter Smiles on (02) 9375 4322 or me on (02) 9375-4422.

Yours sincerely

Duncan Ramsay
General Counsel and Company Secretary

Direct:	+61 2 9375-4422
Fax:	+61 2 9231-6104
Email:	duncan.ramsay@qbe.com

3 March 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

By email to john.kluver@camac.gov.au

Dear Mr Kluver

CAMAC DISCUSSION PAPER – CORPORATE SOCIAL RESPONSIBILITY

Thank you for the opportunity to make a submission to CAMAC in relation to the Discussion Paper. You will be aware that we lodged a submission dated 30 September 2005 with the Parliamentary Joint Committee on Corporations and Financial Services in response to their Inquiry into Corporate Responsibility (PJC Submission).

Rather than re-state our position on a number of issues addressed in our PJC Submission and also raised in your Discussion Paper and we enclose our submission for your attention.

General Comments

There are some general principles against which any proposal to change directors duties (either to create new duties or to attempt to confirm existing powers of directors) to address issues of corporate social responsibility must be judged. These principles inform AICD's basic submission that no change is required to the law as it stands:

- AICD supports all citizens, both individuals and corporations, acting in a way which is socially responsible.
- Corporations are a mechanism for pooling and managing other people's money, and directors are fiduciaries for that purpose. That central focus must

remain in our corporate law, otherwise the basis for making directors accountable for their actions will be undermined. This view is supported by ASIC's submission to the Parliamentary Joint Committee, which points out that requiring, or permitting, directors to take into account the interests of a wide group of stakeholders without this central focus undermines the basis for effective enforcement of directors' duties.

- However, corporations must also meet changing societal expectations, otherwise they will not be commercially successful, and directors know that. It informs both their short and long term decision making. For that reason, directors of solvent companies can and do take into account the legitimate interests of all of those affected by corporate actions. They generally do not engage in the simplistic exercise implied by questions about trading off interests between stakeholders. The existing law is sufficiently robust to support this approach. This is generally consistent with the "Commercial" view expressed in the CAMAC Discussion Paper.

- The existing law of directors' duties has proved flexible in accommodating changing societal expectations of corporations for over 100 years. That flexibility could be undermined by amendments which state that stakeholder interests may or must be taken into account or specify specific stakeholder interests for that purpose.

- The range of specific laws dealing with environmental, social and economic regulation (which generally apply to all kinds of business enterprise, and whether or not incorporated in Australia) are a better mechanism for creating specific obligations to wider stakeholder groups in Australia than imposing generalised duties under the Corporations Act.

- It is not appropriate to address every current concern about the ethics of conduct by individuals or corporations by change to laws. The market has demonstrated its willingness to act against companies who move beyond ethical expectations. The thought that there should be a legislative solution to each lapse of "moral" conduct leads to over-regulation – so called "red tape" – increasing the cost of doing business to enterprises which are ethical in their conduct and to consumers, and reducing flexibility and resources available for innovation.

- AICD does not support any further legislative requirement dealing with sustainability or "triple bottom line" reporting. AICD supports effective and transparent communication by companies with their shareholders and markets. Many companies are recognising the benefits of recognising and reporting on non-financial matters. Companies should be able to distinguish themselves in this area having regard to their individual circumstances without having imposed on them a further compliance burden or an inflexible reporting framework.

CAMAC Terms of Reference

The Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, has requested CAMAC to consider and report on the following matters. AICD's responses to these matters are set out below:

1. Should the Corporations Act be revised 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? **No – see pages 9-13 PJC Submission**

2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions? **No – see pages 9-13 PJC Submission**

3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how? **Australian companies see socially and environmentally responsible conduct as a necessary ingredient of success. Having said that, AICD has no objection to, and sees value in initiatives by Government and industry which encourage, on a voluntary basis, responsible conduct in areas of identified need - see page 14 of the PJC Submission**

4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities? **No - see pages 14-17 PJC Submission**

Additional Comments on CAMAC Matters 1& 2

AICD confirms our view expressed in the PJC Submission that the *Corporations Act* does not hinder Australian companies or directors from taking into account the interests of all stakeholders. Directors of Australian companies can already, and often must at law, take into account a wide range of interests in performing their duties to the company and its shareholders. On this basis we believe that the *Corporations Act* should not be revised to require directors to take into account the interests of specific classes of shareholders or the broader community when making corporate decisions. Nor do we consider that the *Corporations Act* should be revised to clarify the extent to which directors may take into wider interests when making corporate decisions.

Our current system is capable of fulfilling legitimate corporate social responsibility objectives. For the vast majority of Australian boards, determining the "interests of the company" as a sustainable entity is not a question of trade-offs between competing stakeholder interests. Australian boards generally operate on the basis that to be sustainable, a corporation must maintain a reputation for ethical conduct and accommodate the legitimate interests of shareholders, employees, customers, business partners, the communities affected by their operations and the environment.

This approach is necessary to meet both changing societal expectations and the requirements of law. It is evident from the annual reports, corporate responsibility statements and sustainability reports of leading companies that aspire to "best practice" in this area, as well as the many codes of conduct, environmental impact and community projects and charitable programs reported on the websites of many Australian listed companies. It is also clear from these materials that many Australian companies are intent on ensuring that these values are adopted at all levels of the organisation. The disclosure by a number of larger companies requiring those who participate in their supply chain to sign onto the social and environmental standards demonstrate that such an approach has been adopted by them as a pre-requisite to doing business.

Additional Comments on CAMAC Matters 3 & 4

AICD is strongly opposed to mandating any form of corporate social responsibility reporting. First, there is no agreed definition of 'corporate social responsibility'. Mandatory reporting without definitional certainty would be counter-productive. Secondly, rapid international developments in this area mean that mandating reporting is premature.

However, Australian companies are actively engaged in considering corporate social responsibility issues despite the absence of mandatory reporting requirements. A cursory examination of annual reports and addresses by chairmen at annual general meetings from the last reporting season shows a huge variation of content and reporting styles by companies in their attempt to demonstrate what they see as their broad responsibility to shareholders, employees, customers, the environment and the community in general. In other words, the current situation is highly self-regulatory with the market (for the company's goods and services, as well as availability of labour and capital) being a powerful force for superior performance.

The existing market driven disclosure of companies' corporate social responsibility practices is more easily tailored to the individual profile of companies and the emerging expectations of investors and other users of the reports. Mandatory reporting requirements, even for certain types of companies, could lead to some boards to adopt minimum compliance and a "tick the box" approach.

For listed companies, the issue is already covered by ASX Principles 3, 7 and 10 where companies report on their promotion of ethical and responsible decision making, their recognition and management of risk (both financial and non financial risks) and their recognition of their legal and other obligations to their legitimate stakeholders. Standards Australia Corporate Governance Guidelines have also been widely adopted voluntarily by listed, unlisted, public and private sector bodies in Australia.

If prescription is required which AICD does not believe to be the case, AICD would consider some additional guidance around ASX Corporate Governance Council Principles 3 and 7, which is developed by industry and sits outside the Principles. The flexibility of the ASX Principles' 'if not, why not approach' achieves the goal of enhanced disclosure without stifling flexibility or innovation.

We would welcome the opportunity to discuss these important matters with you further. In the meantime, please do not hesitate to contact me on (02) 8248 6600 or Gabrielle Upton on (02) 8248 6635 should you have any questions.

Yours faithfully

Ralph Evans
CEO

AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS
ABN 11 008 484 197

NATIONAL OFFICE

Level 2 National Australia Bank House
255 George Street Sydney
NSW 2000 Australia
TELEPHONE 02 8248 6600
FACSIMILE 02 8248 6633
aicd@companydirectors.com.au
www.companydirectors.com.au

Submission

to

Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Responsibility

30 September 2005

Executive Summary

The Australian Institute of Company Directors (AICD) is the principal professional body representing directors in Australia. Its members are directors of a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, and government and semi-government bodies.

AICD strongly endorses the concept of corporate responsibility.

However, legislation and regulation should only prescribe minimum standards of behaviour. AICD considers that those minimum standards have already been addressed. Further, the plethora of state and federal legislation is sufficient to permit (and often require) directors to take into account the interests of the broad range of stakeholders in managing a corporation. The *Corporations Act* does not hinder Australian companies or directors from taking into account the interests of all stakeholders in a way that is necessary to ensure that a company is successful and sustainable.

AICD also believes that there is no justification for imposing a generalised “social responsibility” obligation on Australian companies that is not also imposed on individuals and other forms of business enterprise.

More than most phrases, “corporate social responsibility” (CSR) means different things to different people. This threshold difficulty of a clear definition makes it inappropriate for mandated behaviour.

For the vast majority of Australian boards, determining the “interests of the company” as a sustainable entity is not a question of trade-offs between competing stakeholder interests. Australian boards generally operate on the basis that to be sustainable, a corporation must maintain a reputation for ethical conduct and accommodate the legitimate interests of shareholders, employees, customers, business partners, the communities affected by their operations and the environment. This approach is necessary to meet both changing societal expectations and the requirements of law.

This is evident from the annual reports, corporate responsibility statements and sustainability reports of leading companies that aspire to “best practice” in this area, as well as the many codes of conduct, environmental impact and community projects and charitable programs reported on the websites of many Australian listed companies. It is also clear from these materials that many Australian companies are intent on ensuring that these values are adopted at all levels of the organisation. The “ripple” effect can also be seen from the disclosure by a number of larger companies that they require those who participate in their supply chain to sign on to the social and environmental standards they have adopted as a pre-requisite to doing business.

The *Corporations Act* should not be amended to impose an additional generalised social responsibility obligation. If the Parliamentary Joint Committee for Corporations and Financial Services (PJC) nonetheless considers that legislation is required, it should only be permissive.

It would also be inappropriate to mandate further CSR based reporting obligations. There is already significant momentum in the development of sustainability reporting, both in Australia and internationally. The current diversity in this area reflects the "journey" that companies must take in developing sustainability standards and reporting methodologies suitable for their individual circumstances. It is clear that there is not a single model that would suit both large and small companies. AICD is also not convinced that there is any benefit to the Australian community in pre-empting the ongoing international debate in this area.

Introduction

All Australians operate in a social system of which legal obligation imposed by parliaments is only part. Ideally, laws should only deal with those things without which the society cannot operate safely, peacefully and in good order. This is the true essence of democracy – that apart from these things, citizens are free to pursue their own morality. As societal expectations of the conduct of its members change, citizens who fail to meet these expectations are generally not successful in the long term.

It is neither feasible nor desirable to look to the law to prescribe all of the matters necessary to engender good citizenship. This is as true of corporations as it is of individuals. AICD does not support the imposition by law of generalised "social responsibility" obligations on corporations (and their directors) which do not apply equally to individuals and other forms of enterprise.

In addressing the matters set out in the PJC's terms of reference published on 23 June 2005, the AICD hopes to demonstrate that:

- Australian companies must be able to act flexibly to meet changing societal expectations and the legitimate interests of "stakeholders". Existing law accommodates this.

- The vast body of existing state and federal law is sufficient to require corporations and their directors to meet the same standards of social responsibility as individuals and other forms of business enterprise without the need to impose a generalised obligation to do so under the *Corporations Act*. The areas in which legislative change could be useful are in supporting business judgements and permitting courts to authorise prospectively actions by directors.

- The overwhelming majority of Australian corporations operate as good citizens, acting well beyond their legal obligations because "enlightened self-interest" dictates that they do so to be sustainable in the long term: to manage reputation risk, to be profitable, to be able to hire suitably qualified staff, to identify and satisfy customer needs and to be welcome members of the communities affected by their activities. No further encouragement through legislation is required.

- The existing legal accountability of directors to shareholders is essential to promote good financial performance, and that accountability should not be diluted. Good financial performance is the best platform for meeting the expectations of stakeholders. Although some commentators perceive a tension between the interests of different stakeholders, while a company is a going concern that "tension" must be resolved and those interests accommodated if the corporation is to be reputable and sustainable in the long term. It is at the point of insolvency that stakeholder interests truly diverge, and there are existing mechanisms in the *Corporations Act* to deal with this.

- It is a mistake to look to the law for the whole answer. The vigilance of the media, the increasing activity of various investors, unions and other interest groups, the existing legal and accounting framework and the disclosure practices adopted to meet the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (particularly Principles 3, 7 and 10) operate to make transparent Australian corporations' ethical standards and practices, without the need for parliament to impose further disclosure obligations. These mechanisms promote accountability of directors and companies in a timely and flexible way without encouraging greater recourse to law suits which would become problematical if a generalised "social responsibility" obligation were imposed.

Existing regard for stakeholder and community interest

Directors of Australian companies can already, and often must at law, take into account a wide range of interests in performing their duties to the company and its shareholders.

In forming corporate strategies, modern directors in fact take account of these diverse interests. Not only do they do this to satisfy any relevant minimum legal requirements, but also because they are acutely aware that if a company is to be reputable and sustainable, it must be able to demonstrate that the social, environmental and economic expectations which stakeholders legitimately have of the company are taken into account. Directors are also aware that these expectations shift over time, and that, in general, expectations – economic, social and legal – only increase.

Laws which apply generally

There is a large range of legislation which applies with the same force to corporations as it does to individuals. This legislation prescribes minimum standards which any person must observe. To name but a few examples of such legislation (often replicated at both state and federal level):

- environmental,
- financial services,
- human rights, equal opportunity, sex and racial discrimination,
- industrial relations,
- native title,
- occupational health and safety,
- taxation, and
- trade practices and fair trading.

Much of this legislation requires directors and other officers to take account of interests other than shareholders, often in preference to shareholders.

Existing corporate law

While there are many theories of "the corporation"[1], the courts have long recognised that directors put a company's survival at risk if they solely pursue profits and fail to take into account the impact of their decisions on a wide range of stakeholders. As long ago as 1883, in considering the powers of a company and the proper exercise of directors' duties under corporate law, the English Court of Chancery affirmed that:

> "…. you cannot say the company has only got power to spend money which it is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company given to them [by Companies Act] are always to be limited to the strictest possible view of what the obligations of the company are. …. Most businesses require liberal dealings. The test there again is not whether it is *bona fide* but whether, as well as being done *bona fide*, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carry on of the company's business for the company's benefit. ….. a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond would soon find itself deserted – at all events unless labour was very much more easy to obtain in the market than it often is."[2]

Today, the general duties of directors at common law are codified in sections 180-184 of the *Corporations Act*. These duties permit directors wide discretion in their actions, but they do require directors to act with care and diligence, in good faith and through the focus of the interests of the company, acting for the benefit of the company and for the purpose for which a power was conferred, and not to secure an advantage to themselves or others. The AICD considers this to be the proper focus for Australian companies and that it is flexible enough, taken with the general capacity of Australian companies to do anything which a natural person may do under section 124 of the Act [3], to accommodate the legitimate interests of all stakeholders.

There are a range of other provisions of the *Corporations Act* which require directors to take account of specific other interests: for instance, at the time of fundraising and takeovers and at times of uncertain corporate solvency.

[1] See paragraphs 1,380-1,400 and 7,610-7630 of *Ford's Principles of Corporate Law* (12th Edition, 2005) by Professor HAJ Ford, The Hon. Justice RP Austin and Professor IM Ramsay for a useful discussion of these theories and a concise bibliography of relevant academic discussion.

[2] See *Hutton v West Cork Railway Co* (1883) 23 Ch D at pp 672-3 per Bowen LJ. This case is notable for the line: "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company".

[3] Corporate capacity can be limited by provisions in a company's constitution, but such limitations are rare in commercial enterprises. They are more generally found in the constitutions of companies limited by guarantee for the purpose of ensuring that the company's funds are used for specific charitable purposes and in order to satisfy the requirements of taxation authorities for eligibility for treatment as "charitable" institutions.

Existing practices

The corporate governance practices disclosed by Australian companies in response to the ASX Corporate Governance Council's Recommendations demonstrate the following:

- The overwhelming majority of the S&P Top 200 companies[4] have codes of conduct which recognise that to act in the best interest of the company, they must take into account the interests of other stakeholders, including employees, customers, the environment and communities affected by the company's activities.

- Many companies have separate "corporate social responsibility reports" or "sustainability reports", which cover extensively the performance of the company in social, environmental and governance areas[5]. These reports often reflect on conduct over successive periods. They have the impact of reinforcing the values expressed in the codes of conduct by demonstrating both to the community and the employees of the organisation that they abide by those codes. There are some companies which do not currently provide reports which have indicated that they are considering when and how to implement such reporting against growing community expectation[6]. There has been a growth of a range of plans which support charitable donations by companies and their employees. Some are "matching" plans under which companies match charitable donations made by employees. Other plans allow employees paid leave to pursue charitable projects.

[4] Representing at least 90% of the market capitalisation of the ASX. Source: review conducted by national law firm Freehills in September 2005.

[5] Examples (primarily derived from S&P/ASX 100) include: ANZ (www.anz.com.au); AGL (www.anz.com.au); BHP Billiton (www.bhpbilliton.com); Bluescope Steel (www.bluescopesteel.com); Boral (www.boral.com); Brambles (www.brambles.com); Santos (www.santos.com.au); National Australia Bank (www.nabgroup.com); Newcrest Mining (www.newcrest.com.au); Origin Energy (www.originenergy.com.au); Oxiana (www.oxiana.com.au); Paperlinx (www.paperlinx.com); Rio Tinto (www.riotinto.com); Telstra (www.telstra.com.au); Transfield Services (www.transfieldservices.com.au); Wesfarmers (www.wesfarmers.com.au); Westpac (www.westpac.com.au). Many of these are based on reporting structures such as the Global Reporting Initiative, but some are not. Other companies (not listed above) have sustainability policies against which they have some reporting, without a formal sustainability report.

[6] An example is Amcor, which says on its website:" Community expectations have changed. Amcor recognises that a 'meeting compliance' approach does not satisfy the expectations of stakeholders and we are conscious of the need to increase our public reporting of environmental and social issues. It is also critical that as a company we understand how we are progressing along the sustainability journey. In determining what aspects of sustainability to concentrate upon Amcor is working with its stakeholders. We recognise that our objectives will develop over time with increased dialogue and understanding between stakeholders.

Amcor's commitment to sustainability is supported by policies, objectives and targets, management procedures, continuing research and regular reporting and auditing. More specific information relating to Amcor's environmental and social ethics, which form an integral part of our overall sustainability can be found in dedicated sections of this website. Another lynchpin of our attitude to this vital part of who we are is embodied in our Mission Vision and Values - which is at the core of everything we do".

- Many have community support programs: for instance financial literacy programs, schemes for the support of indigenous communities, regional projects supporting Landcare Australia and the Royal Flying Doctor, support for the Salvation Army (and similar charities dealing with poverty and homelessness), HIV Aids support, hands on learning with youth, provision of school resource information, support for medical research and development, support for local sporting teams. This sort of listing does not do justice to the range and depth of many of these programs.

It is a notable feature of the charitable and community support programs that most are related to the core business of the company, where the company is best positioned to see the need and serve it (eg financial literacy programs, regional land care, indigenous community programs) and where their operations are relevant to a local community. Some companies seek community partnerships, where their employees can participate by volunteering and have input to the development of the partnership. Corporations are sometimes criticised for failing to be sufficiently "philanthropic" – making charitable donations because doing so benefits the corporation by helping to attract staff or promoting the welfare of the communities in which they do business, not because they are a genuinely disinterested "good" people. However, AICD considers that the linkage is appropriate, as well as being supported by the requirements of existing law.

There is a range of contributing factors to these developments which may include:

- increased investor and press scrutiny of how companies act in relation to social, environmental and governance matters facilitated by the developments such as the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations and similar codes[7],

- the increased sensitivity of share price to illegal or socially unacceptable practices. A number of the recent corporate collapses have been characterised by revelations of bad practice where the corporation's "brand" has been so fatally affected that business became unviable (eg Arthur Andersen), or where the threat to the "brand" has caused new practices to be adopted (eg clothing and sporting companies whose exploitative use of third world labour has resulted in customer boycotts),

- the need to be able to attract qualified staff, who are sensitive to the "ethos" and reputation of an organisation in a global market, and

- the pressure of special interest groups expressed through participation in shareholder meetings, active press and internet campaigns and class actions.

There is a general correlation between the sophistication and extent of the development of codes, sustainability reports and charitable and community support programs and market capitalisation[8]. This is to be expected because it generally reflects both the funds available to

[7] Eg the UK Combined Code, the amendments to the NYSE rules and enforcement of investor standards publicised in the so called Investment & Financial Services Association "Blue Book".

[8] It is observable that many of the companies that are listed overseas (particularly the UK) may also be further along the path in "sustainability" reporting. While size and industry no doubt play their part, this may also be because they have had longer exposure to the "if not, why not" reporting of the Combined Code – and the

the companies and the greater impact that the bigger companies have on the communities in which they operate as well as the practicalities of communicating and maintaining corporate culture in large organisations.

No legislative revision required for stakeholder interest to be taken into account

The AICD strongly recommends that the *Corporations Act* not be amended to require directors to take into account the interests of specific classes of stakeholders or the broader community when taking their decisions. AICD believes that the introduction of a generalised duty cannot be justified for the following reasons:

Directors need a way to prioritise among competing interests and a basis for accountability

Imposing a generalised CSR obligation on companies, especially through the mechanism of a change to directors' duties, will unsettle the fundamental "compass" of directors – the fact that they are stewards of other people's money and owe fiduciary duties to the company as a whole. That may have a range of consequences which are unpalatable and undesirable from a policy perspective.

The terminology in the CSR debate is inherently vague. Terms like "stakeholder", "community" and even "social responsibility" mean different things to different people, and at different stages of the social development of the broader community. These terms suggest that anyone identifiable as a "stakeholder" or a member of a "community" as such has an interest equally worthy of protection at all times. The AICD does not accept that this is the case.

As a practical matter, a generalised duty would be difficult to formulate – which "stakeholders" should be chosen? This intimately affects accountability.

- If the law is changed so that directors owe a duty to "stakeholders", it may perversely mean that directors and corporate management become less accountable because their duty is too generalised and they obtain too wide a discretion in how they expend corporate funds. It would make it harder for shareholders and regulators to call directors to account for poor performance because having too many masters dilutes accountability.

- If the law is changed so that directors owe a duty to named stakeholders (in addition to shareholders), it will necessarily leave out some which the current law is flexible enough to accommodate[9].

advent of the ASX Corporate Governance Council's Principles and Recommendations may result in greater uptake of this practice over time in Australia.

[9] Charitable and political donations become particularly difficult here. Under current law, the requirement to demonstrate corporate benefit tends to govern the extent and nature of the giving. If charities and political

The AICD considers that the balance created by the current law is more appropriate.

- As the *Corporations Act* is currently drafted, the focus of directors' accountability while the company is solvent is its shareholders, with the cases in which that obligation is to be overridden set out in other specific legislation.

  - As indicated previously, while the company is solvent, directors can take into account the interests of other stakeholders in performing their duties. For instance, charitable or political donations relevant to the company's business are permissible.

  - The interests of other stakeholders are supported as well by provisions such as section 1324 of the *Corporations Act* which allows a person whose interests have been or would be affected by a corporate activity in contravention of the *Corporations Act* to seek an injunction to prevent an action or require an action to be carried out or damages in appropriate cases.

  - At different stages of the company's life cycle – for instance – where solvency becomes doubtful, other interests come into focus and change entirely once the company goes into external administration (where the board's role may be supplanted entirely). Because the business is no longer sustainable, the interests of stakeholders other than creditors recede almost entirely – for instance, charitable giving would no longer be permissible.

- There is already a plethora of specific laws which mandate director's conduct in specific areas of activity. As a matter of policy, it is preferable that the occasions on which shareholder interests are to be overridden should be the subject of narrow, case by case legislation, rather than under a general requirement under the *Corporations Act*. Such specific laws provide clear guidance for directors about what is expected of them, and insulates the directors against claims by shareholders for failure to guard their interests properly.

- If a generalised duty to "stakeholders" is included in the *Corporations Act*, it would greatly expand the jurisdiction of the Australian Securities and Investments Commission (ASIC), in a way which is not desirable. ASIC is a disclosure and markets regulator: that is its expertise. If the obligation to "stakeholders" is expanded, then ASIC would have to deal with a much broader class of complaint and complainant. That would unduly tax its resources and expertise, and give rise to a great deal of duplication between its duties and those of other regulators.

parties are not included as "stakeholders", this form of giving may be jeopardised entirely. If they are included – unless there are other provisions governing such dealings – the floodgates would be opened. It is notable that in the UK, there is a proposal to regulate political donations without shareholder approval (See part N of the exposure draft clauses)

It may impact investor confidence and the efficacy of companies as a collective investment vehicle

Corporations are an efficient vehicle for the collection and centralised investment of savings. It is bad public policy to shake the confidence of investors that their invested funds will be used other than primarily for their benefit, especially in an environment where compulsory superannuation contributions direct funds into equity markets. It could disadvantage Australian companies as a destination for international funds and thereby impact employment opportunities by prejudicing the capacity to amass investment funds necessary for enterprise building and job creation in Australia.

It may affect Australia as a destination for incorporation

A generalised "social responsibility" obligation imposed under the *Corporations Act* is likely to apply only to Australian companies, and that may drive incorporation outside this jurisdiction and thus lessen Australian regulatory control. While Australia needs to maintain a reputation for a modern regulatory system, it should not be a market leader in the imposition of such duties in this area.

No justification for applying corporate social responsibility obligations to companies and not other entities or individuals

There is no justification for applying a generalised CSR duty on directors or corporations which does not apply to individuals and other forms of business enterprise.

It is flawed and overly simplistic to think of companies as "rich people" who can afford philanthropy[10]. Companies already pay taxes and contribute to the society by employment and the provision of goods and services and they represent the retirement savings of many Australians.

In any event, not all companies are substantial – the top 200 ASX listed companies account for over 90% of the market capitalisation. There are a further 1,300 listed companies, and many of them cannot afford to comply with all of the recommendations made by the ASX Corporate Governance Council. Apart from listed companies, there are hundreds of thousands of other Australian companies of all types, only some of which might be described as substantial. Yet many of these companies are important for the development of new ideas and industries and they are collectively significant employers (but without substantial discretionary resources).

Clarification

[10] See the article in *The Age* on 11 August 2005 by Professor Mirko Bagaric and James McConville entitled "Social dividend the way for the super prosperous" – suggesting a compulsory charitable donation for companies who are very profitable.

The AICD considers that the *Corporations Act* does not need to be amended to clarify (by amendment to those sections which deal with directors' duties) the extent to which directors may take into account the interests of stakeholders or the broader community when making their decisions.

If, however, the PJC decides that clarification is useful, AICD suggests that the PJC should take the following matters into account in making its recommendation:

- There should be a specific statement that any clarification is intended to be without prejudice to anything which directors could at law do prior to the amendment. Otherwise, the inclusion of some cases (eg employees and customers) may raise questions about whether other cases (eg the environment or suppliers or the communities affected by the company's operations) are now excluded by their omission.

- There should be a specific statement that any clarification does not amount to a requirement and does not confer on stakeholders a greater right to sue the company or directors than any of them might have had before the clarification was made.

- It is best to avoid words like "stakeholder" and lists of particular stakeholders. There are a number of states in the United States which have included in their laws permissions for directors to take into account the interests of named classes of stakeholders. The UK[11] is similarly considering such a clarification. However:

  - The formulations are all different, so there is no standard formulation.

  - In the United States, the "clarifications" overwhelmingly relate to conduct in takeovers, not to the general duty of directors. Notably, Delaware (the jurisdiction of preference for incorporation of most US listed companies) has no such provisions.

  - The formulations are generally relatively limited: employees, customers, suppliers, and sometimes the environment, and sometimes the communities affected by the company's activities.

  - All of the formulations operate in relation to the "company" and not the group of which the company forms part. [12]

What would be the best clarification?

[11] Item B(3) of the UK Company Law Reform Bill introduced in May 2005 which followed from the UK White Paper on Modernising Company Law is available on the UK Department of Trade and Industry website at www.dti.gov.uk.

[12] By way of interest, if any of the CSR debate is generated by the issues surrounding James Hardie, this formulation would not have helped, first because James Hardie is no longer an Australian company – so it is unaffected by any amendment to the *Corporations Ac*t. Second, the issue related to liabilities to former employees and users of products manufactured by subsidiaries of James Hardie, not James Hardie itself.

If the PJC opts for clarification of directors' duties, AICD suggests the word 'best' be removed from section 181(1)(a) *Corporations Act*. Section 181(1)(a) would then read:

"181(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the interests of the corporation; and
(b) for a proper purpose."

The reason for suggesting this change is that it would enable directors to consider a wider scope of alternatives and interests in making their decisions. It would take away any argument that the directors were not acting properly in the "best" interest of a corporation when they did so. It would also assist directors by removing the "hindsight" element inherent in judicial review of directors' decisions – societal understandings of what may be "best" can change between the time at which directors act, and the time a court may come to review them. This language is also more in line with the common law understanding of the duty.

AICD also recommends that the business judgement rule in section 180(2) of the *Corporations Act* be extended. If directors are increasingly called upon to have regard to a broad range of interests, they should also be given an appropriate 'shield' for doing so. When the Government introduced the business judgement rule as a defence to section 180, the Treasurer said that if the rule was a success, the Government would consider extending its application. AICD recommends extending the business judgement rule to sections 181-184, (but especially to section 181(1)), because this would support directors in taking a broader perspective in making their decisions in the interests of company, whilst maintaining the appropriate controls.

Are there other amendments to the *Corporations Act* required?

Give the court power to approve future actions of directors – expand section 1318(2)

Section 1318

Section 1318 allows a court wholly or partly to relieve a director from civil liability for negligence, default, breach of trust or breach of a specific directors' duty if the court decides that the director has acted honestly and that, in the circumstances, the director deserves to be excused. Section 1318(2) allows relief to be granted when a director "apprehends" that a claim will be made against him or her for, among other things, negligence or breach of duty.

The James Hardie case, through the decision of the NSW Court of Appeal in *Edwards,* has focussed attention on the shortcoming of section 1318(2) of the *Corporations Act*. The court found that section 1318(2) only gives the court jurisdiction to protect directors in respect of past conduct and not future actions, even when the future actions are the same as the past conduct sought to be relieved.

It is noteworthy that while all other corporate administrators[13] have various rights to approach the court for advice or directions about future conduct under the *Corporations Act*, and trustees have some rights under trustee legislation of the various States, directors alone lack this facility. Attached in the Schedule to this submission is some brief background in relation to the *Edwards* case which demonstrates the difficulty faced by directors and the courts once a company is in a position of doubtful solvency.

AICD suggests that section 1318(2) should be amended to permit a court to provide prospective relief to directors from the consequences of well defined decisions, where the safeguards described in the Schedule to this submission have been met.

Are there any voluntary measures by which Australian companies could be encouraged to adopt socially and environmentally responsible business practices?

It is appropriate first to point out that the vast majority of Australian companies do act in a socially and environmentally responsible way, for all of the reasons previously mentioned. Having said that, AICD considers that there are some examples of appropriate ways for Government to support worthwhile industry-based initiatives.

The introduction of the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations – based on "if not, why not" disclosure - has encouraged many companies to adopt codes and practices which are relevant. Because these recommendations are not prescriptive, they have allowed companies to respond innovatively and given companies necessary flexibility to take into account issues such as the purpose for which they were created, their stage of development and the resources available to them.

AICD is aware that there have been a number of specific industry-based initiatives – such as the Commonwealth Government's Consumer and Financial Literacy Challenge. AICD supports this type of initiative which can be developed in consultation with industry groups, promoting well targeted use of socially relevant programs by companies with specific expertise.

AICD suggests that it is appropriate for the Government to lend its support to initiatives such as Computershare's E Tree, which promotes electronic communications between companies and their shareholders, limiting the need for paper communications. AICD notes that the CLERP 9 electronic communications legislation helped to facilitate this initiative. AICD considers that such facilitative legislation – rather than prescription – rewards and promotes innovation in ways that contribute to the sustainable development of the whole community.

Current reporting requirements associated with these issues are appropriate

[13] See section 424 for controllers (which includes receivers), s467D for administrators and sections 479(3) and 511 for liquidators, including provisional liquidators by section 472.

Australian companies are currently subject to reporting requirements under a number of specific statutes, for example, occupational health and safety and environmental legislation. There is however, no current legislation requiring companies to report on CSR issues. AICD would be strongly opposed to mandating any form of CSR reporting.

One of the primary reasons for AICD's opposition to any mandatory reporting is that there are threshold definitional issues surrounding the subjects of CSR and 'triple bottom line'. As previously mentioned, the phrases mean different things to different people. This definitional confusion is not unique to Australia – views on what constitutes CSR differ internationally. The question "what does CSR mean" would elicit very different responses from a European, who looks to a broad range of stakeholders on one hand, and an American, who takes a far more black letter view, on the other hand.

These differing views are the result of cultural, structural and social differences. AICD believes that the debate surrounding these threshold definitional issues is still under way and that for Australia to move to mandatory legislation before the debate is fully developed would be premature. For example, when the phrase 'triple bottom line' was given wide publicity by Elkington in the 1990's it was readily adopted as useful shorthand for considering issues that were not purely financial or tangible. Ten years on, the phrase 'triple bottom line' is probably too limited to describe the sorts of subjects many would consider are encompassed by the phrase 'corporate social responsibility'. Change in this area is rapid.

The increasing rate of change in this area is a further argument against imposing any form of mandatory CSR requirements. For a good illustration of the rate of change in this area see two of the major findings of the recent KPMG International Survey[14]:

- Corporate responsibility reporting has been steadily rising since 1993 and it has increased substantially in the past three years.

- A dramatic change has been the type of corporate responsibility reporting: changed from the purely environmental reporting up until 1999 to sustainability (social, environmental and economic) reporting which has now become mainstream among G250 [Top 250 companies of the Fortune 500] companies (68 per cent) and fast becoming so among N100 [Top 100 companies in 16 countries] companies (48 per cent).

If Australia were to move to mandatory reporting on CSR there is the potential for it to be caught between the more inclusive European view and the more prescriptive American view. AICD believes that neither of these approaches is suitable for Australia's particular circumstances. The difficulty of wholesale adoption of overseas approaches in Australia before the position is settled internationally has been best illustrated recently by the Australian move to international accounting standards. Australian companies have been grappling with moving to international standards some of which are proving to be unsuited to Australian conditions. AICD cautions against moving to prescription in an area that it still developing and which is changing rapidly.

[14] 'KPMG International Survey of Corporate Responsibility Reporting 2005', KPMG Global Sustainability Services, Amsterdam, 2005 at page 4

The absence of any mandatory Australian CSR reporting requirements does not mean that Australian companies are not actively engaged in considering CSR issues and reporting on them. The Top 100 Australian companies were considered by the KPMG international survey[15]. A number of these leading Australian companies have adopted and continue to refine highly innovative and sophisticated approaches to this type of reporting without any form of prescription. Reports from companies in the insurance, mining and banking sectors are good examples of this type of reporting. These companies see CSR as fundamental to their business sustainability. For these companies, CSR is about good business practices; they see good reporting on CSR as being the way they do business and as giving them an advantage over their competitors.

Companies that are innovators in this area are also responding to the increased interest in recent years of a broad range of investors in their approach to CSR. More Australians than ever before own shares either directly as a result of demutualisations or indirectly through their superannuation contributions to the large funds. AICD believes that as the pool of retirement savings grows investors' interest in CSR will continue to grow without any legislative intervention.

The other difficulty with moving to any form of mandatory reporting in this area is that how a company approaches the issue of CSR is necessarily highly individual. The issues facing a multinational mining company dealing with a range of local communities, a telecommunications company with significant operations in rural and regional Australia and a small listed information technology company are very different. Any regulation that might suit the needs of these companies would be either too high level or imprecise to encompass all the differences and therefore unenforceable, or so sector specific that it would be too complex and prescriptive. Clearly no one model suits the needs of all of these different types of companies. AICD members involved in CSR issues report that each company addresses these issues differently at different stages in their development and that different approaches suit companies at particular stages.

There are reporting frameworks in existence such as the Global Reporting Initiative (GRI) which is widely used by a number of large companies internationally and by a number of the larger Australian companies. AICD would not support mandating adoption of the GRI in Australia nor in any other framework. AICD believes that reporting on CSR in Australia is at a very early stage and mandating any particular approach is likely to stifle innovation and experimentation by companies and to lead to a mentality where directors and management focus on compliance only. The United Kingdom has recently introduced a requirement for listed companies to produce an 'Operating and Financial Review' (OFR). AICD believes the Australian 'Management Discussion and Analysis' is a good approximation for the OFR and does not see a need for introducing the OFR into Australia.

AICD would also argue that, at least for listed companies, which take their CSR responsibilities seriously, the issue is already covered by ASX Principles 3, 7 and 10 where companies report on their promotion of ethical and responsible decision making, their recognition and management of risk and their recognition of their legal and other obligations to their legitimate stakeholders. Although the ASX Principles only apply to listed companies a number of AICD members report that supply chain relationships are moving smaller

[15] KPMG Survey at page 38

companies towards a broader recognition of CSR issues. This trend is likely to continue. The other development in this area is the Standards Australia Corporate Governance Guidelines which have been widely adopted voluntarily by listed, unlisted, public and private sector bodies in Australia.

While AICD opposes any form of mandatory CSR reporting; the existing market driven disclosure of companies' CSR practices is more easily tailored to the individual profile of companies and the emerging expectations of investors and other users of the reports. If the PJC considers that increased CSR is needed, AICD would be prepared to consider some additional guidance around ASX Corporate Governance Council Principle 3, which is developed by industry and which sits outside the Principles. The incorporations by reference to the G100 publications: 'Guide to Review of Operations and Financial Condition' and 'Guide to Compliance with Principle 7 in the ASX Principles are good models. AICD suggests that the best method of achieving meaningful disclosure of companies' CSR activities is to avoid mandatory 'one size fits all' reporting. The flexibility of the ASX Principles' 'if not, why not approach' is preferable and achieves the goal of enhanced disclosure without stifling flexibility or innovation.

Conclusion

AICD welcomes the opportunity to make this submission to the PJC and would be pleased to address any questions you have either in person or by further submission.

SCHEDULE

Edwards case

In *Edwards*, an application was made by the directors of Medical Research and Compensation Foundation, a company limited by guarantee (Foundation), established to act as trustee of the fund created by James Hardie to compensate people with asbestos related disease as a result of exposure to James Hardie asbestos products. The application was also made by them as directors of Amaba and Amaca, the former James Hardie subsidiaries (now owned by the Foundation as a result of 2001 scheme of arrangement) which had conducted the James Hardie asbestos operations.

The particular difficulties faced by the directors and the court were:

- If the directors paid all current claims made by those with asbestos related diseases (for which there were sufficient funds both now and for the immediate future), the pool of funds available to future claimants (who were not currently identified, because they had not yet fallen ill, but were almost certain to exist in the next 40 years) would be exhausted before all possible claims were dealt with.

- However, if the directors appointed a provisional liquidator, then substantial funds would be expended in the provisional liquidator coming up to speed on relevant issues, and more importantly, the payment of agreed claims would be compromised both as to timing and amount. As the court pointed out, the lifespan of someone with an asbestos related disease is generally not long after diagnosis, and this meant that many who suffered from the disease whose claims had been processed would not have the comfort before their death of knowing that their family had been provided for.

- The appointment of a liquidator would have the effect of barring the very future creditors whose claims theoretically meant that the fund was insufficient. This is because future identified creditors claims could not be made in the liquidation because they were not “creditors” at the time of the liquidation (see below in relation to “who is a creditor”). Therefore even though there was a real possibility that the Foundation might be given access to further funds arising out of the negotiations between James Hardie and the unions, if the liquidation had started they may not assist the future identified claimants.

- The directors were concerned that, even though they were acting honestly and trying to do their best by those likely to be affected by asbestos disease, they could be personally liable and guilty of insolvent trading (or failure to preserve the assets of the fund) if they continued to make payments while this issue was uncertain[16]. They were unable to obtain insurance. There was no point in appointing a receiver, since the receiver also could not get insurance.

[16] Their application to the court was in June 2004.

The way forward

AICD considers that, as demonstrated in the *Edwards* case, where directors are acting honestly and the scope of the proposal is well defined, there is a good case for such an amendment to section 1318(2) to permit the court to authorise directors' actions prospectively. This is especially so where – as here – the directors were unable to obtain insurance. To quote Young CJ:

> "154 Whilst it is important to ensure that people do not misuse the corporate veil and the principle of limited liability and trade whilst insolvent, it is also necessary to see to it that where companies are in a precarious position they are managed by people with the appropriate business expertise. One consequence of the trading whilst insolvent provisions is that such expertise is not available to companies because of the justified fear that personal liability might attach or even that there will be an attempt by a creditor to say that personal liability attached which can only be tested in an expensive set of proceedings.
>
> 155 The solution latterly suggested by Mr Jackman (counsel for one of the parties) of receivership is, with respect, just another manifestation of the way in which the *Corporations Act* compels companies in a precarious financial position to spend mega dollars on accountants to endeavour to salvage their position instead merely of appointing more experienced directors to the board. However, as the law at the moment does not permit a court to announce absolution in advance it will only be in rare cases that the Court can do anything about the matter".

The court has previously noted that directors stand alone among corporate administrators in their inability to seek directions in relation to future conduct[17]. The court therefore has wide experience in providing assistance of this kind.

AICD suggests that a proposal might encompass the following features:

- The court would be given an expanded jurisdiction under section 1318(2) to give advice to directors and to authorise prospective action which might otherwise give rise to liability for negligence, breach of trust or breach of duty (including insolvent trading).
- Recognising that courts are often uncomfortable with making orders which can affect the rights of people not represented before it unless they have been given an opportunity to be heard:
    - an application to the court might require advertisement so that shareholders or affected creditors can object;

[17] See para 28 of *Edwards Case*

- the court should be empowered to appoint a "contradictor" which could assist the court in ensuring that all relevant issues are raised.

- The court would need to act on a defined proposal and it would be the job of the directors to formulate it and to attest to its commercial desirability, pointing out to the court, to the extent that they are aware, the way in which the proposal might affect the interests of shareholders and creditors, as well as any personal interest they might have. The court should have discretion to limit the implementation of any proposal to a particular time frame or dollar amount or dealings with specified persons. That should be left to the discretion of the court, but the court should be given express power to extend the timeframe or scope of a proposal for which it has previously granted an order.

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Submission by the
New South Wales Young Lawyers Pro Bono and Community Services Taskforce
to the
Corporations and Markets Advisory Committee

Corporate Social Responsibility Discussion Paper

February 2006

Introduction

According to a communication dated 16 November 2005 released by the Corporations and Markets Advisory Committee (**CAMAC**), the Australian Government has asked CAMAC to consider a series of questions related to responsible corporate conduct, including aspects of corporate decision-making, corporate reporting and whether further measures are needed to encourage socially and environmentally responsible business practices. CAMAC has released a public discussion paper calling for public submissions on the questions that have been raised.

The New South Wales Young Lawyers Pro Bono and Community Services Taskforce (**Taskforce**) wishes to make submissions to CAMAC in response to a number of the requests for submissions in the discussion paper.

The Taskforce's submission

We have briefly addressed the requests for submissions set out in sections 1.5, 2.7, 3.4, 4.8 and 5.7 of the discussion paper. We also generally refer CAMAC to the Taskforce's September 2005 submission (**PJC Submission**) to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Corporate Social Responsibility (**PJC Inquiry**). A copy of the PJC Submission forms annexure A to this submission.

Throughout our submission, the terms listed below have the following definitions:

> **stakeholder**, in respect of a particular corporation, means non-shareholder individuals and groups, including the wider community, which are or are likely to be affected (whether directly or indirectly) by the acts or omissions of that corporation. The definition extends from company employees to groups in other countries (for example, populations affected by pollution or climate change caused by the activities of corporations in other countries), to groups which may arise in the future (for example, a generation which may not be able to experience seeing certain environments or species due to destruction or extinction); and
>
> **corporate responsibility** means the commitment of companies to contribute to sustainable economic development by considering and working with their stakeholders (based on the definition used by the World Business Council for Sustainable Development, 2004).

Request for submissions section 1.5:

1. *How might corporate social responsibility usefully be described for working purposes?*

2. *Which approach or combination of approaches to responsible corporate behaviour is most appropriate?*

3. *What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?*

4. *Do different or additional implications arise depending on the nature or size of the enterprise, for instance:*

   (a) *the sector or industry in which an organization operates; or*

   (b) *whether a company has international operations?*

5. *In practice:*

   (a) *to what extent is corporate decision-making driven by stakeholder concerns?*

   (b) *how do companies differentiate between various categories of stakeholders?*

   (c) *in what ways do companies balance or prioritise competing stakeholder interests?*

   (d) *how do companies engage with stakeholders?*

6. *In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company?*

7. *Are there any changes that could enhance triple bottom line, sustainability or like reporting, including:*

   (a) *increasing the level of clarity and comparability of these reports;*

   (b) *any suggested changes to external verification of those reports;*

   (c) *whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s); and*

   (d) *are there particular issues for small to medium enterprises?*

Taskforce's response:

How might corporate social responsibility usefully be described for working purposes?

1. See the definition of “corporate responsibility” at the beginning of this paper.

Which approach or combination of approaches to responsible corporate behaviour is most appropriate?

2. Our PJC Submission adopts what the discussion paper (p 25) defines as an “ethics based” approach to corporate responsibility. That is, the Taskforce sees corporations as having a responsibility to carry out their activities taking into account the interests of other stakeholders or more broadly to undertake their activities but not at the expense of the environment, labour rights, human rights, etc.

What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

3. See (in relation to the legal background) our response to the Request for Submissions section 2.7 and to Term of Reference (c) in the PJC Submission. In more general terms, at present companies operate in a climate where increasing public scrutiny and debate have caused a number of companies to re-evaluate the way they do business. However, until directors are entrusted with a duty other than to make money for shareholders, most companies will continue to operate within the limits of the law with minimal regard for other stakeholders. In this regard companies that are more forward-thinking are potentially placed at a competitive disadvantage, which has contributed to the majority of companies operating with little regard for stakeholders.

Do different or additional implications arise depending on the nature or size of the enterprise, for instance:

(a) the sector or industry in which an organization operates; or

(b) whether a company has international operations?

4. While it may be more important for companies with a greater impact on the community and environment (such as those of the type outlined in paragraph 3 of our response to Request for Submission section 4.8) to report on their corporate responsibility activities, the approach set out in paragraph 2 above can and should apply to all companies.

In practice:

(a) to what extent is corporate decision-making driven by stakeholder concerns?

(b) how do companies differentiate between various categories of stakeholders?

(c) in what ways do companies balance or prioritise competing stakeholder interests?

(d) how do companies engage with stakeholders?

5. See our response to Term of Reference (a) in the PJC Submission.

In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company?

6. Stakeholders are increasingly taking a more sophisticated view of companies and will (time and access to information permitting) look at a company's record of corporate responsibility when deciding how they should interact with it.

7. In one example of successful stakeholder action, American universities have run boycott campaigns against Nike's uses of sweatshops to manufacture its goods, which have had a direct effect on Nike's business practices.

8. However, this type of effective action is rare. Companies may argue that they are driven by their customers' wants and choices, and would act more sustainably or produce more sustainable goods if their customers or shareholders demanded it. However, the ubiquity and demonstrated effectiveness of advertising and other forms of corporate persuasion indicate in fact that companies have far greater power to influence consumer decisions than consumer decisions have to influence companies. JK Galbraith goes so far as to call the concept of consumer sovereignty a "fraud" (*The Economics of Innocent Fraud* p13, Penguin Books 2005).

Are there any changes that could enhance triple bottom line, sustainability or like reporting, including:

(a) increasing the level of clarity and comparability of these reports;

(b) any suggested changes to external verification of those reports;

(c) whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s); and

(d) are there particular issues for small to medium enterprises?

9. See our response to the Request for Submissions section 4.8 and to Term of Reference (f) in the PJC Submission. The Taskforce re-affirms its view that triple bottom line reporting must be made mandatory for all incorporated entities in Australia. This is the only guaranteed way to enhance its effectiveness.

10. However, by itself triple bottom line reporting is insufficient to protect the wider community from the harm that companies can cause (James Hardie being the most prominent recent example). To ensure adequate protection, directors' duties need to be

amended to ensure that they take into account the need to protect other stakeholders – see further our response to Request for Submissions section 3.4.

Request for submissions section 2.7:

1. *Whether, or in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions.*
2. *If so, is there any useful scope for clarifying the current law in this respect?*
3. *Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?*
4. *If you have any proposal for change, how might it be implemented and work in practice and how might directors be held to account?*

Taskforce's response:

> *Whether, or in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions.*

1. See our response to Term of Reference (c) in the PJC Submission, in relation to the current legal framework.

2. Overall, the current legal framework does not directly discourage directors from having some regard for the interests of employees, suppliers and customers, and the consequences of corporate activities on the environment, the broader community and stakeholders generally. However, circumstances may arise where directors feel constrained or uncertain in exercising their discretion to take into account stakeholder interests, given the legal emphasis on prioritizing the interests of the company (primarily conceived of as shareholder and creditor interests).

Current uncertainty as to duties

3. In determining whether companies feel constrained by the current formulation of the law regarding directors' duties, a key issue to note is that uncertainty as to the scope of the power to consider stakeholders and broader community interests in itself constrains a director's exercise of this discretion. Directors need to know to whom duties are owed and the extent of the obligation to consider stakeholder interests. More specifically, if a director must act in the best interests of the company, what is meant by "the company"?

Does it strictly refer to the shareholders or is there some degree to which a director may consider the interests of other stakeholders? If stakeholders' interests were considered, should such considerations still be made with the objective of maximising shareholder wealth?

4. Diverging views and the general uncertainty over the application of the principle of the "best interests of the company" will dissuade directors from investigating stakeholder considerations and engaging in activities which are not strictly in the short-term interests of the shareholders of the company.

5. This is exemplified by the James Hardie scandal, where directors stated that they were concerned that they would breach directors' duties if they used shareholder funds to provide additional compensation to asbestos victims (see E Sexton, "Directors: to whom do they own care?", Sydney Morning Herald 4 July 2005).

Directors' fiduciary obligations

6. Directors have fiduciary obligations to the corporation's investors that mean that the corporation is constrained in its activities, and does not have the same discretion to allocate its assets as does an individual.

7. However, more directors are becoming aware that it will generally be for the benefit of the company as a whole for directors to act ethically and consistently with the interests of the wider community (see the discussion of "enlightened shareholder value" below). There is an ever increasing risk for Australian companies that their goodwill, reputation and business will be damaged if directors fail to consider the interests of these stakeholders and the broader community, and there is no law which prevents them from acting to minimise that risk.

Directors' statutory duties

8. The *Corporations Act* 2001 (Cth) (**Corporations Act**) and relevant common law principles do not directly prevent corporate officers from taking into account the interests of stakeholders. While there is no direct legal obligation in company law on directors to take the interests of stakeholders into account, this does not preclude directors from choosing to do so (Senate Standing Committee on Legal and Constitutional Affairs *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* November 1989).

9. Statutory duties contained in Part 2D.1 of the Corporations Act complement common law and equitable duties requiring directors to "act bona fide for the benefit of the company

as a whole" (*Mills v Mills* (1938) 60 CLR 150 at 188) and the courts have associated directors' duties with the "interests of the company". This does not necessarily preclude directors from considering other interests, as long as the directors also consider the company's interests in making a decision.

10. The case law in this area indicates that directors may implement a policy encouraging consideration of broader community interests, but may not be generous with company resources when there is no likelihood of commercial advantage to the company. (See RP Austin, HAJ Ford and IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (2005) 281-282).

11. In *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288, a Canadian Court said:

> Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders.

12. The "interests of the company" include the continuing well-being of the company. Directors must not act for motives foreign to the company's interests, but the law permits them to consider many interests and purposes, as long as there is also a purpose of benefiting the company. (See JD Heydon, 'Directors' Duties and the Company's Interests' in P Finn (ed), *Equity and Commercial Relationships* (Law Book Company, 1987) at 135.)

Business Judgment rule

13. The business judgement rule established in s180(2) of the Corporations Act gives directors some leeway in making commercial decisions, provided the conditions as set out in that section are satisfied. Business judgments must be made in good faith and not for irrelevant purposes (see *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483).

14. As Q Digby and L Watterson state, "Courts are generally reluctant to interfere in matters that involve the exercise of a commercial judgment, especially where a range of decisions could have been made by a director in a particular circumstance. … Business judgments are less likely to face legal challenges when a company fosters reasonable care, diligence and transparency in day-today operations" ("Pursuing profit, productivity and philanthropy: the legal obligations facing corporate Australia", *Keeping Good Companies* June 2004 p266-271).

15. If a company makes a philanthropic or stakeholder-oriented decision which might also generate intangible benefits for the company (such as increased goodwill towards the business and good publicity), courts will be cautious in second-guessing the business decision of the directors, so directors need not feel constrained in making such decisions. The extent to which directors are aware that they can make use of this freedom to consider stakeholder interests is, however, debatable.

If so, is there any useful scope for clarifying the current law in this respect?

16. See our response to Term of Reference (d) in the PJC Submission.

17. As discussed above, there is some uncertainty as to the extent to which and the manner in which directors may consider stakeholder interests, and uncertainty as to how the law will be applied, which discourages decision-makers from straying too far from established short-term shareholder-interest principles. It would be useful to clarify the scope of current laws in relation to the above issues.

18. A clarification might help prevent another James Hardie-type scandal. The Australian Financial Review stated that “James Hardie chairwoman Meredith Hellicar has said protections might have helped the board in funding asbestos victims it was not legally obliged to pay” (F Buffini, “Leave responsibility to us, says business”, 24 November 2005).

19. The current government sentiment that businesses should voluntarily develop and implement technologies to reduce greenhouse gas emissions provides an additional incentive for clarification that costs in doing so are legitimate business expenses and could not provide the basis for shareholder suits against the company. (See statements by politicians and analysis of this issue reported in J Breusch “Minister places faith in shareholder conscience”, Australian Financial Review 10 January 2006; W Frew, J Freed & S Peatling “Trust firms on climate, say leaders”, Sydney Morning Herald 12 January 2006; J Breusch “Greenhouse summit rejects fossil fuel cuts”, Sydney Morning Herald 13 January 2006; and “Australia dodges the issue on climate change”, Sydney Morning Herald editorial 14 January 2006.)

Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?

20. Directors must act in good faith and in the best interests of the company (Corporations Act s181), as reflected in the present and future interests of the shareholders as a whole (as noted by Q Digby and L Watterson in the article cited in section 14 above).

21. In support for this proposition, Helsham J stated in *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSWR 424 at 440 that directors should consider the interests of future as well as existing shareholders. The leading commentator LCB Gower noted that the phrase “the best interests of the company” does not refer to the:

> sectional interest of some or even a majority of the present members or even all of the present members, but of present and future members; that the directors should balance a long term view against the short term interests of present members.
>
> (‘Corporate Control: The Battle for the Berkeley’ (1955) 68 *Harvard Law Review* 1176, 1184-1185).

22. Alternatively, the principle can be expressed so that the duty of directors is not to take into account the interests of future members so much as the future interests of present members (IA Renard, “Commentary” in P Finn (ed), *Equity and Commercial Relationships* (1987), 137, 138).

23. There is growing acknowledgment that a narrow focus on short-term profits actually undermines the shareholder wealth maximisation objective. (See Melving Aron Eisenberg, “Corporate Conduct That Does Not Maximize Shareholder Gain: Legal Conduct, Ethical Conduct, the Penumbra Effect, Reciprocity, the Prisoner’s Dilemma, Sheep’s Clothing, Social Conduct, and Disclosure” (1998) XXVIII(1) *Stetson Law Review* 1.)

24. As a result, directors should not feel confined by law to short-term considerations in their decision-making, such as maximising immediate profit or share price return. The interests of a company can legitimately include its continued long-term well-being. The extent to which directors are guided by this principle in practice is, however, debateable.

If you have any proposal for change, how might it be implemented and work in practice and how might directors be held to account?

25. See our response to Request for Submissions section 3.4.

Request for submissions section 3.4:

1. *Should the Corporations Act be revised 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?*

2. *Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

3. *Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties?*

4. *Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?*

5. *If a pluralist approach were to be adopted:*

   (a) *should directors be permitted to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions? or alternatively,*

   (b) *should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

   (c) *in either case, what broader interests should be identified?*

   (d) *how might any proposed amendment be implemented and enforced?*

6. *If an elaborated shareholder benefit approach were to be adopted:*

   (a) *what form should it take?*

   (b) *would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments?*

   (c) *how might any proposed amendment be implemented and enforced?*

Taskforce's response:

> *Should the Corporations Act be revised 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?*

1. The Taskforce refers to its response below and generally to Term of Reference (d) in the PJC Submission.

Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties?

2. In summary: The Taskforce recommends change in the present position governing directors' duties. (Improving standards of corporate governance would also help prevent egregious corporate behaviour of the kind which has recently received media attention.) However, there are potential disadvantages with both the pluralist and the elaborated shareholder benefit approaches, largely relating to practicability and enforceability, and potentially conflicting duties. Of the two, the elaborated shareholder benefit approach appears more workable.

3. In relation to this latter approach, the recent UK Company Law Reform Bill, with certain refinements, provides a possible method for making directors more accountable to stakeholders.

4. We also consider that Robert Hinkley's proposed amendment to the Corporations Act (as detailed in his submission to the PJC Inquiry), while taking a slightly different angle, remains persuasive. Mr Hinkley's proposal is to amend section 181 of the Corporations Act through the addition of what he terms a "Code for Corporate Citizenship". The effect of this amendment would be to require directors to continue to act in the best interest of the corporation, but only if it is "not at the expense of the environment, human rights, public health and safety, the dignity of employees, or the welfare of the communities in which the corporation operates".

5. Another possible approach may be to enact separate legislation regarding duties to stakeholders. These approaches are discussed further below.

Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?

6. The Taskforce considers that corporate law should, as a minimum, be clarified so as to explicitly allow directors to consider stakeholder interests where the company's proposal could have an adverse effect on those stakeholders. This would remove the current confusion as to directors' duties (see on this our response to Request for Submissions section 2.7) and provide a greater sense of protection and encouragement for directors

already taking stakeholder interests into account. Given the legal position discussed above, this clarification would not necessarily go beyond the current law.

7. As a preferred alternative, the Corporations Act should be amended to require (rather than merely allow) directors to take into account stakeholder interests when considering a course of action which may adversely affect them. Although such a requirement would go beyond the current law, it goes no further than popular opinion (including those of most shareholders) currently demands, and is similar to legislation currently in force in several overseas jurisdictions. Claims of increased costs may be answered by the relative success of SRI funds (see “Investing in ethical firms pays off: study”, AAP, published in the Sydney Morning Herald 30 March 2005).

8. However, the most appropriate vehicle for such an amendment is debated – see further below.

> *If a pluralist approach were to be adopted:*
>
> *(a) should directors be permitted to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions? or alternatively,*
>
> *(b) should directors be required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*
>
> *(c) in either case, what broader interests should be identified?*
>
> *(d) how might any proposed amendment be implemented and enforced?*

9. The pluralist approach advocates directors serving a wider range of interests in corporate decision-making. The Taskforce submits that environmental and consumer protection are both key areas which should be incorporated into directors’ duties if a pluralist approach were adopted.

10. Successful directors already need to be able to make decisions in situations of complexity, to weigh up competing priorities and to consider intangible elements of value such as reputation and good will. Allowing or requiring directors to consider the relative importance of stakeholder and shareholder interests in a particular situation is not qualitatively different.

Disadvantages of pluralist approach

11. However, in serving other stakeholders with the same consideration as shareholders, directors could potentially be subjected to conflicting or competing fiduciary duties. The Taskforce agrees with the comment in the discussion paper that this could ultimately

make enforcement (either criminal or civil) difficult, as it would become increasingly difficult to determine which duties were owed and to whom. Furthermore, if directors were obliged to take into account the interests of shareholders in the pluralist manner, it could in practice severely compromise the role that the shareholders of the corporation have in controlling the directors.

12. The Taskforce submits that while the pluralist approach identifies the key areas for changes and seeks to implement them, it is too onerous for directors to be expected to take on board all responsibilities to balance stakeholders with shareholders.

13. The US has adopted a pluralist approach, but only in relation to taking into account non-shareholder groups or the broader community in the context of corporate takeovers. This context renders it difficult to compare to the suggested changes to directors' duties in the Australian Corporations Act (an Act which is very widely applicable).

If an elaborated shareholder benefit approach were to be adopted:

(a) what form should it take?

(b) would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments?

(c) how might any proposed amendment be implemented and enforced?

14. The elaborated shareholder benefit (or enlightened shareholder value) approach requires directors to act for the benefit of shareholders of their company as a whole, as under the current law, but taking into account longer term considerations as well as the interests of various non-shareholder groups in advancing shareholder value. That is, the goal of shareholder wealth maximisation is best achieved by taking a long-term approach, and may regularly involve rewarding and compensating various stakeholders.

15. There is some evidence that a moderate form of this approach is already accepted. The business judgment rule allows directors some discretion in making decisions so long as they are ultimately made with a view to maximising shareholder value. Austin, Ford and Ramsay comment:

> An extreme view, namely that a company should make only those expenditures that are directly related to the pursuit of profit for the benefit of members, would restrict management. The decided cases in this area indicate that management may implement a policy of enlightened self-interest on the part of the company but may not be generous with company resources when there is no prospect of commercial advantage to the company.
>
> (As cited in section 10 above.)

16. However, the Taskforce considers that the law needs to be explicit on this point, and preferably mandatory, in that it should require directors to consider, in making corporate decisions, certain groups which could be reasonably considered to be adversely affected by those decisions. This approach would be best implemented by amending the director's duties in the Corporations Act.

17. In this regard the Taskforce re-iterates that careful consideration should be given to Robert Hinkley's proposal to amend directors' duties as set out in his submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry. (See paragraph 5 of Term of Reference (d) in the PJC Submission.)

UK Company Law Reform Bill 2005

18. Clause 156 of the UK Company Law Reform Bill 2005 provides an appropriate starting point when considering the elaborated shareholder benefit approach. Clause 156 is comprehensive, retaining the traditional duty of directors towards shareholders generally but giving a broader context for fulfilling that duty. Clause 156(3)(a)-(f) sets out a list of relevant considerations, which we consider are appropriate, but (d) in particular is still very broad.

19. This breadth and lack of specificity is of some concern, given the wide variety of types of corporations. A method to address this may be to require each company to prepare a list of stakeholders it reasonably considers may be adversely affected by its activities, and submit this list to ASIC for authorisation. If a company fails to prepare a list or ASIC considers the list unreasonable, ASIC may mandate which stakeholders the company should consider, by considering the information listed in the corporation's annual report or calling for further reports from the directors, or from stakeholders. Alternatively, the list could be audited by professional auditors rather than by ASIC.

20. The list should be reviewed annually, and should be published in the company's annual report and/or on its website. Once the list is determined, the company must consider the listed stakeholders as part of its commercial decisions, taking a long-term view of the best interests of the company and ensuring (as per the Robert Hinkley suggestion) that the activities of the company are not at the expense of those stakeholders.

21. The argument that decisions would be impossible as stakeholder interests would conflict may be addressed by suggesting some appropriate considerations, such as:

- which stakeholders are most likely to be affected;

- the extent of the likely damage to the interests of those stakeholders; and
- whether compensatory or “off-set” mechanisms can be put in place to counteract the damage to certain stakeholders.

Conclusion

22. While the current law does not specifically prevent companies from taking into account the interests of stakeholders, there exists considerable room for legislative improvement to ensure that companies do take non-shareholders’ interests into account. Given that corporations have legal privileges and power greater than that of most individuals, they must be both responsible and accountable for their actions.

23. The Taskforce submits that the Corporations Act should be revised to require directors to take into account stakeholder interests in the manner discussed above, as part of a long-term view of the company’s interests. The private sector should be free to pursue profit-making opportunities and private interests within the law, but not at the expense of the environment or broader social concerns.

Request for submissions section 4.8:

1. *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*
2. *Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities?*
3. *Are any changes desirable to any other reporting requirements, such as the ASX Listing Rule requirements, the ASX Corporate Governance Principles or relevant accounting standards, to provide more relevant non-financial information to the market?*
4. *In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form?*
5. *Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles?*
6. *Would an additional environmental or social 'impact' reporting obligation be appropriate and feasible and, if so, how might it be stated?*

Taskforce's response:

1. See generally on the issue of reporting our response to Term of Reference (f) in the PJC Submission.

2. While certain reporting on potential environmental liabilities is mandated under the Corporations Act and associated regulations, and some companies voluntarily provide information on their corporate responsibility programs, this information is insufficient and does not enable a full evaluation of the effect of a company's activities or a comparison between companies.

3. In support of these views, a Sydney University report commissioned by CPA Australia in 2005 found that sustainability reporting by Australian companies "runs the risk of falling behind the rest of the world" (P Weeks "Good intentions", Sydney Morning Herald 16 August 2005). Mark Coughlin, president of CPA Australia, said "…investors are deprived of reliable information that allows them to compare companies and sectors, making informed investment decisions difficult" (P Weeks article, as above). The Australian National Audit Office has published a report advocating triple bottom line reporting (*Cross Portfolio Audit of Green Office Procurement*, released 12 December 2005). The Ethical Investment Association has put forward the business case for corporate

responsibility disclosure, in that it allows better evaluation of the risks a company faces (statement at Sustainable Business Forum debate, 30 November 2005, Sydney).

4. The Taskforce considers therefore that the Corporations Act should require all companies:

   (a) which are of a certain size, for example specified by market capitalization, annual turnover or number of employees (including employees or contractors overseas); and

   (b) regardless of size, which are in areas of business which are more likely to affect stakeholders, eg mining or other resource-intensive or labour-intensive industries,

   (c) to report annually on the social and environmental impact of their business and the manner in which they have investigated and considered stakeholder interests in making business decisions.

5. For maximum accessibility, reliability and comparability, these reports should be:

   (a) in a consistent format;

   (b) audited by professional, independent auditors; and

   (c) included as part of the company's annual reports if the company is required to submit annual reports. If it is not, the reports should be posted on the company's website at the end of each financial year.

6. The Global Reporting Initiative (**GRI**) sustainability reporting guidelines, currently being updated, would provide a convenient and widely accepted framework for these reports. If a domestic (though less comprehensive) alternative is sought, compliance with Principle 10 and Recommendation 10.1 from the ASX Principles could be made mandatory for the types of companies listed in section 3 above.

7. Many countries have already adopted mandatory corporate responsibility reporting, as discussed in section 4.5 of the CAMAC discussion paper, and therefore the move towards mandatory reporting would not impose a distorting burden on Australian companies.

8. As envisaged in section 4.7 of the discussion paper, there is an argument for requiring all entities "whose activities have a significant environmental or social impact" to provide reports on that impact – whether or not they are companies. However, it is likely to be the case that the great majority of large or otherwise significant entities (in whose sustainability activities the public would have an interest) would be corporations.

Request for submissions section 5.7:

1. *Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?*
2. *To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?*
3. *What lessons might be derived from any experience with voluntary initiatives?*
4. *What would be the nature of any proposed initiative, what would be its intended purpose and consequences, how might it be implemented and what would be its costs and other implications?*

Taskforce's response:

1. See generally on the issue of voluntary measures our response to Term of Reference (e) in the PJC Submission.

2. The Taskforce considers that, while Australian companies should adopt socially and environmentally responsible business practices, voluntary measures are not the most effective means to achieve this important (and socially demanded) objective.

3. Previous experience has shown that voluntary measures have insufficient take-up and regulation is required to achieve any meaningful and widespread changes in corporate behaviour. Consider for example Australia's comparatively poor record in sustainability reporting, and the failure of the initial, non-mandatory version of the National Packaging Covenant to attract sufficient adherents.

4. As discussed in our response to Request for Submissions section 2.7, the current state of the law on directors' duties may dissuade many companies from making voluntary efforts to improve their performance.

5. A further difficulty with voluntary measures is that companies may consider that they would be financially disadvantaged if they adopted the measures, as against their competitors which do not do so.

ANNEXURE A: PJC Submission – the Taskforce's submission to the PJC Inquiry

Submission by the
New South Wales Young Lawyers Pro Bono and Community Services Taskforce
to the
Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Social Responsibility

September 2005

Terms of Reference

The Parliamentary Joint Committee on Corporations and Financial Services has been asked to enquire into corporate responsibility and Triple-Bottom-Line reporting for incorporated entities in Australia, with particular reference to:

The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

The appropriateness of reporting requirements associated with these issues.

Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

The TaskForce's Submission

The TaskForce has addressed each Term of Reference in order below. Throughout the submission, the terms listed below have the following definitions:

> **"stakeholder",** in respect of a particular corporation, means non-shareholder individuals and groups, including the wider community, which are or are likely to be affected (whether directly or indirectly) by the acts or omissions of that corporation. The definition extends from company employees to groups in other countries (for example, populations affected by pollution or climate change caused by the activities of corporations in other countries), to groups which may arise in the future (for example, a generation which may not be able to experience seeing certain environments or species due to destruction or extinction); and

“corporate responsibility” means the commitment of companies to contribute to sustainable economic development by considering and working with their stakeholders (based on the definition used by the World Business Council for Sustainable Development, 2004).

Term of Reference (a)

The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community

9. It is difficult to accurately assess the level of existing regard organisational decision-makers have for the interests of stakeholders, due to the lack of requirements for triple-bottom-line or corporate responsibility reporting in Australia, and the lack of consistent definitions of the terms above (the *Corporations Act 2001* (**the Act**), for instance, contains no definition of "stakeholder", and related definitions in other legislation are unhelpful).

6. This submission therefore focuses on information voluntarily provided by individual companies and information provided by independent assessment and survey-style reports, with the unavoidable bias that the companies which choose to provide such information and respond to such surveys would tend to be the companies undertaking significant corporate responsibility activities, rather than the companies which do not undertake any such activities.

7. A further qualification of this submission, in relation to the reliance on self-reporting by companies, is that such reports tend to focus on successful stakeholder outcomes, rather than indicating the extent to which organisational decision-makers have regard to stakeholder interests when making decisions which affect the company. This submission does not attempt to comment on the completeness or transparency of self-reporting, but takes such reports at face value.

Reports and surveys

8. Several surveys support the fact that companies which publish reports on their corporate responsibility programs tend to be either larger domestic companies or companies with an international presence. Less evidence is available in relation to smaller corporations, as these do not tend to publish such reports. However, this may be due to lack of resources or information rather than lack of a sense of corporate responsibility.

9. From the available reports, it appears that many of the larger corporations in Australia do make some attempt to consider stakeholder interests, and some have well developed programs to address corporate responsibility (including Visy, Westpac, BP, BHP Billiton). As a whole, the performance by Australian companies is very mixed. The KPMG International Survey of Corporate Social Responsibility Reporting (2005) (**KPMG Survey –** report available at www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf) found that 23% of the top 100 companies in Australia publish information on their corporate responsibility activities (compared to 64% of the top 250 companies worldwide). The report by the Centre

for Australian Ethical Research entitled "The State of Sustainability Reporting in Australia 2004" (**CAER Report**) found a similar figure.

10. Internationally, the Ernst & Young survey entitled "Corporate Social Responsibility: A survey of global companies" (2002) (**E&Y Survey**) found that corporate responsibility is emerging as a significant business issue, with 73% of the companies surveyed (147 companies from the Global 1000) indicating it is high on the boardroom agenda, and 72% stating that they had or were developing corporate responsibility strategies. 73% of international companies surveyed by the Economist Intelligence Unit stated that their company undertook corporate responsibility activities, but only 15% said that corporate responsibility was a central consideration in most business decisions (reported in "The Way of the Merchant – Corporate Social Responsibility in Japan", May 2005).

11. The Australian Corporate Responsibility Index run by the St James Ethics Centre (**CRI**) provides useful information on the level of corporate responsibility shown by companies in Australia – or would do, if more companies participated in the (voluntary) survey. Only 27 companies participated in the second CRI survey (reported in April 2005), from the more than 250 top Australian companies invited to do so – a response rate in the order of 10%. The less gruelling survey for the CAER Report had a response rate of approximately 20%. It is hard to avoid the conclusion that many of the non-responding companies (which are not small struggling companies) had either:

a lack of interest in the subject matter of the survey, reflected in a lack of internal resources allocated to answer the survey, or

a desire not to provide information which may not reflect well on the company.

12. As may be expected, the companies which did respond to the CRI survey showed a relatively high level of corporate responsibility activities. There are considerable differences in performance even among this self-selected high-performing group. Of the 27 companies in the second CRI survey, six achieved the highest score and six the lowest.

13. Professor Michael Adams, UTS, reports that "A survey of 98 of Australia's leading corporates found that being a good corporate citizen was not generally seen as being central to core business or the way a company was organized or run" (presentation 2 August 2005, Sydney). Although companies may undertake some corporate responsibility activities, these may be seen as peripheral to the "real" business of the company. A company may dedicate some resources to undertake corporate responsibility activities, but the extent to which the company's decision-makers consider the interests of stakeholders when making business decisions is another, and more difficult, question.

Other considerations

14. The motivations to undertake and report on corporate responsibility activities are reported to be a combination of ethical/philanthropic and business-oriented motives including reputation enhancement, risk minimisation, employee attraction and retention, and maintaining a strong market position (see the KPMG Survey and the CAER Report). Corporate responsibility programs tend to direct a company's philanthropy or ethical policies in a wide variety of ways most useful for the company.

15. The types of stakeholders which corporations consider include (but are not limited to):

employees;

disadvantaged individuals;

community groups and non-profit organisations;

public institutions;

other commercial groups or organisations, and

policy makers.

16. Companies may focus on one or two stakeholder groups or corporate responsibility areas such as the environment, health or education, often chosen in light of the company's core activities and markets, rather than undertaking a complete spectrum of corporate responsibility programs. Companies are increasingly considering their supply chain, in addition to actions taken directly by the company itself.

17. Differences in approach to corporate responsibility appear not only as a factor of the size of companies, but also in relation to their sphere of business. It appears that companies providing or relying heavily on physical resources or otherwise with significant environmental impact (for example, companies in the mining, energy or paper fields) tend to put more emphasis on corporate responsibility programs than service-based companies (see the KPMG Survey). Nonetheless, there has been an increase in corporate responsibility activity and reporting in the financial sector (KPMG Survey), also reflected in the success of Westpac in achieving the highest score in the 2004 CRI survey.

Impediments

18. The Taskforce submits that there are a number of factors impeding the ability of decision-makers to consider the interests of stakeholders in developing and implementing company policy. These include:

the duty of directors to ensure companies make money for shareholders;

competing stakeholder interests;

lack of generally-accepted definitions of relevant terms, including “stakeholder” and “corporate responsibility”;

lack of generally-accepted guidelines as to reporting corporate responsibility activities;

a low rate of awareness in organisations as to their internal corporate responsibility agenda, which undermines effective incorporation of the interests of stakeholders by decision-makers. The international E&Y Survey found that “Only 19% of companies believe that their corporate responsibility agenda had been effectively promoted and understood throughout the organisation”;

difficulties in ensuring that company decision-makers have complied with company policy in relation to corporate responsibility, in any one decision;

economic constraints placed on a company by its shareholders, or by the perceived dictum that a company must act solely in the interests of its shareholders rather than stakeholders; and

a lack of external reporting requirements, undermining the ability to track a company’s corporate responsibility performance against its stated policies.

Term of Reference (b)

The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community

10. As the Taskforce's submission in Term of Reference (a) indicates, the level of regard organisations have for the interests of stakeholders varies along a continuum, from those organisations which have no apparent regard for such interests, to those which evidence considerable stakeholder dialogue and engagement. In this submission, the Taskforce considers which point in the continuum is the most desirable, with regard to incorporated entities in Australia at this point in time.

19. It may be argued that the ideal point in the continuum varies depending on the type of organisation (its size, products or services and their by-products or environmental/social impact). It also depends on the group of stakeholders in question, particularly if stakeholders have conflicting interests. As a minimum, the Taskforce submits that all companies should as a matter of basic responsibility:

identify their stakeholders and the interests of each stakeholder group, and update these assessments regularly; and

as part of each significant business decision, assess the ways in which and extent to which those decisions, and more generally the company's activities, products, services and other impacts, are likely to affect those interests.

Beyond this minimum, the Taskforce considers below the arguments for greater and lesser consideration of stakeholder interests.

Pros and cons: arguments for and against corporate responsibility

20. It is commonly argued that companies should only consider the interests of their shareholders, as these people have invested in the company or given up something of value which they risk losing. If a company focuses its resources on stakeholder interests, it is "cheating" its shareholders (see Gary Johns' 2002 Hal Clough Lecture, "Corporate social responsibility or civil society regulation?" available from the Institute of Public Affairs, and the article by John Blundell entitled "Companies exist only to trade – nothing else", available on www.iea.org.uk).

21. Under the definition of stakeholder introduced in the Taskforce's response to Term of Reference (a), all stakeholders risk losing something of value to them within the activities of the corporation. Shareholders may lose money whereas future generations may lose an

irreplaceable environment. Also, this future generation has "given" something of value to the company, assuming that the ability to use the finite environmental resources in question was useful to the company (see also the discussion of the commercial merits of social responsibility below – few shareholders today, if they were asked, would fail to recognise the valuable risk management and reputation enhancement functions of corporate responsibility, helping to maintain a company's value over the long term).

22. Secondly, the Taskforce submits that companies are not the appropriate forum in which to resolve social problems as they do not have the appropriate expertise or resources. This is the province of governments, which are democratically elected. Allied to this is the view that corporate responsibility weakens democratic government (see Gary Johns' paper above and his article "Insurance company whips up a storm" in the *Australian Financial Review,* 16 August 2005). These arguments lose force if the government legislates for corporate responsibility, as the Taskforce submits that it should do in response to Term of Reference (d). Furthermore, corporate responsibility does not require a company to become expert in new fields of environmental science or social policy – merely to understand and consider the effects that its own activities may have. The Taskforce submits that it is irresponsible for companies to undertake activities without such understanding.

23. Thirdly, there is the argument that companies are already obliged to consider the interests of certain stakeholders by extensive legislation dealing with employee rights, safety, anti-discrimination, privacy and environmental protection as well as other areas (see Gary John's paper "Deconstructing corporate social responsibility", 2005, Institute of Public Affairs). However, the very specificity of most such legislation (while it is still of benefit) encourages a compliance mentality, where companies aim to comply with the letter of the law rather than incorporating corporate responsibility principles more centrally into the company (see also the Taskforce's response to Term of Reference (a) in relation to the extent to which companies have an existing regard for stakeholder interests).

24. A further argument that companies should have regard for the interest of stakeholders is the fact that in certain spheres, large companies today are richer and more influential than many governments, and can have an enormous effect on local communities, the environment and other stakeholder interests. Considering the number of people a multinational company employs, the resources it uses, its supply chain, the effects its products or services have on communities, the waste products it produces, companies can no longer be seen as merely an artificial form of private person.

Commercial reasons in favour of corporate responsibility

25. The following factors lend weight to the argument that organisational decision-makers, in the direct interests of their company should take into account stakeholders' interests in business decisions:

an effective form of risk management: dialogue between organisational decision-makers and stakeholders allows for the development of problem solving mechanisms and improves the overall quality and effectiveness of organisational decisions, as stakeholder input at an early stage may indicate community expectations and help resolve problems before they pose significant difficulties for the company or the community;

a commercial advantage for the company: such dialogue also provides a degree of transparency and allows some stakeholder monitoring of business transactions, which is likely to enhance the company's reputation and give rise to better relations with community members / customers / target audiences; and

as employees and potential employees are increasingly demanding that their employers are socially responsible, a company which demonstrates its high level of corporate responsibility and sensitivity to stakeholders may become an employer of choice.

26. Institutional investors are increasingly recognising the above factors and are starting to take a company's level of corporate responsibility into account for investment purposes. This is a further reason for companies to improve their performance in this area (see generally on these issues: Brad Howarth article "Character building", *Sydney Morning Herald* 23 July 2005; Andrew Cornell and Bill Pheasant article "Sick of red tape, keen for social action", *Australian Financial Review* 11 April 2005; Juno Consulting paper "Making sense of corporate social responsibility", 2004, available on www.junoconsulting.com.au; Chris Barry article "CIS green fury at Exxon boss", *Manchester Evening News* 26 May 2005).

27. As a minimum, the Taskforce submits that companies should identify stakeholder interests and how they may be affected by the company's activities. We suggest that a greater level of consideration of stakeholder interests (for example, by undertaking stakeholder dialogue) is justified by the great influence of companies in society today and by the commercial reasons in favour of such consideration.

Term of Reference (c)

The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community

Care, skill and diligence

1 The current legal framework, the Act, states that directors must show reasonable care and diligence and act in the interests of the company and for a proper purpose. This includes the duty to act with reasonable care and diligence (s180), in good faith in the best interests of the company and for a proper purpose (s181) and not to improperly use their position or information (ss182/183). The Act has codified directors' duties to reflect the judicial decisions that all directors are expected to take reasonable care to guide and monitor the management of a company (*Daniels v Anderson* (1995) 37 NSWLR 438).

2 Directors must make a business judgment in good faith for a proper purpose, have no material personal interest in the matter, inform themselves appropriately, and rationally believe that the judgment is in the company's best interests: s180(2). The business judgment rule ensures that directors are responsible for the risks that they take and are not shielded from liability. Under the current framework, directors must not improperly use their position or any company information in any way to gain an advantage for themselves or to harm the corporation.

3 It is acknowledged in the decision in *ASIC v Rich* [2005] NSWSC 62 that directors have a special role to "articulate and apply a standard of care that reflects community standards" and that the standard has been raised "over the last century or so". It was acknowledged in this decision that these responsibilities are not part of the current legal framework.

4 With reference to the Jackson Inquiry (in relation to the James Hardie company), it is argued that the current legal framework encourages directors to ignore the interests of stakeholders because their legal duties are to achieve what is in the best interests of their shareholders. In the James Hardie example, the corporation relocated to The Netherlands, while simultaneously undermining the interests of asbestos victims by under-funding the Medical Research and Compensation Fund, a separate company set up by James Hardie to compensate victims. As a result, the corporation faced financial as well as social condemnation for upholding and protecting the interests of its shareholders over the interests of other stakeholders (i.e. its victims).

5 Since 1 July 2004, publicly listed companies in Australia have been required to have in place and post on their website, a Code of Conduct and Ethics indicating how they intend to deal with stakeholder concerns and interests. However, this is not stated anywhere in the Act with respect to directors' duties.

Directors' fiduciary duties

6 Through the current legal framework, directors have a fiduciary relationship with their corporation (ASX Principles of Good Corporate Governance and Best Practice Recommendations). Fiduciary obligations often arise where one person is under an obligation to act in the interests of another, but this does not necessarily mean that the obligation to act in the interest of another is a fiduciary obligation (*Aequitas v AEFC* (2001) 19 ACLC 1,006). The provisions of the Act supplement the fiduciary duties, however the fiduciary duties, being the general law and not statutory, do not apply to other officers as defined in s.9 of the Act such as a secretary, a de facto officer, or person administering a compromise or arrangement involving the corporation.

7 Generally, directors owe fiduciary duties to the company and its shareholders and not, for example, to stakeholders such as creditors or minority shareholders (*Percival v Wright* [1902] 2 Ch 421; *Southern Cross Mine Mgt v Ensham Resources* (2004) 22 ACLC 724). Therefore a company may enforce fiduciary duties owed by a director. A reason for this is that otherwise, directors would be liable and exposed to a multitude of actions (*Brunninghausen v Glavanics* (1999) 17 ACLC 1,247 at 1,254 per Handley JA).

8 Directors must "have regard to the interests of the members of the company, as well as having regard to the interests of the company as a commercial entity": *Darvall v North Sydney Brick & Tile Co Ltd. & Ors* (1988) 6 ACLC 154 per Hodgson J. So in some circumstances directors' fiduciary duties may be extended, for example where directors issue new shares to advance their own interests and disregard the interests of their shareholders (*Ngurli Ltd v McCann* (1953) 90 CLR 425).

9 The exceptions to the general rule that fiduciary duties are only owed to the company are limited and can be categorised as follows:

(a) where there is a voluntary assumption of trust and confidence by the directors, e.g. where directors encourage shareholders to have trust and confidence in them such as when they hold themselves out to shareholders as acting as their agents;

(b) special facts, i.e a director has sole control of information about the matter that gives that director a "special opportunity" to exercise that advantage to another's detriment (*Brunninghausen v Glavanics* (1999) 17 ACLC 1,247).

Directors' duty to creditors

10 Section 588G of the Act is designed to protect creditors by dealing with the criminal liability of directors for insolvent trading by their company. A director contravenes s588G if the director had reasonable grounds for "suspecting insolvency". This requirement of "suspecting insolvency" requires a director to predict the company's future financial capacity.

Directors' wider duties

11 Critics of corporate responsibility say that it takes too much focus off the bottom line (Chapman F "Corporate Governance and CSR – one vision for all" (2005) 8(5) IHC). Ultimately, a director of a company must obey the law in running that company in the best interests of its shareholders. However, the shareholders do not include the community, environment or greater public. The current legal framework does not take into account the interests of stakeholders other than shareholders and creditors.

12 Interestingly, companies believe that their duty to the community consists of complying with the law. If directors choose to put their the interests of the community (whatever those interests might be) ahead of the interests of the shareholders they would run the serious risk of being in breach of their present duties under the Act. The James Hardie example has further brought this issue into focus, regarding its dealings with those who contracted asbestos-related diseases as a result of contact with James Hardie products.

13 As environmental issues and directors' duties are not covered by the Act, recent cases suggest that the Courts are on occasion willing to look beyond the parameters of the corporation to consider the impact that company directors have on the community as a whole. The recent decision of *National Roads and Motorists' Association Ltd v Geeson* (2001) 39 ACSR 401 established that in particular circumstances, directors may have a "public duty" to act or refrain from acting in order to adhere to what is in the best interests of the community as a whole, rather than according to what is in the best interests of the company. The comments of Bryson J in this decision showed that it is possible for a common law duty to exist for directors to comply with principles of sustainable development.

14 If directors are expected to run their companies taking into account the interests of stakeholders, then they must have adequate protection via a legal framework, so that they will not be liable to suits brought by shareholders on the grounds that the directors are breaching their duties to shareholders.

15 The Taskforce submits that unless directors' duties within the Act are widened to encompass duties to stakeholders other than shareholders,

directors must continue to comply with the current framework and act in the best interests of their shareholders.

Term of Reference (d)

Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

11. As our response to Term of Reference (c) noted, companies are not required to give consideration to any stakeholders, other than shareholders and, at times other persons in certain exceptional circumstances. Under the current legal framework directors will be prohibited from considering stakeholders if their interests conflict with those of the shareholders.

28. There are times where the interests of shareholders will conflict with those of stakeholders. Particularly with consideration to the cultural change that has emerged from the Jackson Inquiry and the current CAMAC Inquiry, it is important for directors and entities to, at a minimum, have the opportunity to act in the interests of stakeholders in these circumstances of conflict. There must be revisions of the current legal framework so that where there is a conflict, directors and entities have a clear power to act in the interests of stakeholders that are not covered by the current legal framework.

29. There is a lot of uncertainty about when a conflict does arise, often as shareholders' interests are measured with consideration to short-term results, whereas the interests of stakeholders tend to be long-term. This uncertainty discourages directors from acting in the interests of stakeholders, even where there may be the desire to do so.

30. The Taskforce considers that, to ensure that entities and their directors are either enabled or required to consider stakeholder interests, the legal framework must be revised. The revisions must alter the current effect of the provisions of the Act and the most appropriate mechanism for doing this is to make an amendment to the Act itself. This legislation must determine the rights and obligations of entities and its directors, and changes to enable or require stakeholders to be considered should be incorporated into the Act.

Duty upon directors not to adversely affect the interests of stakeholders

31. One alternative is to amend the duties of the directors to incorporate a duty that the conduct of the entity does not adversely affect the interests of stakeholders. This would require the interests of stakeholders to be considered in all aspects (see Bob Hinkley's 28-word amendment).

32. Such an amendment, while effective in ensuring that the interests of stakeholders will be considered, is a long-term objective. We support such a revision of the legislative framework in Australia but suggest a less burdensome amendment to the legislation in the short term.

Right to consider stakeholders

33. Another alternative is to amend the duties of the directors to consider the interests of stakeholders when determining what is in the best interests of the company, rather than create a whole new duty. Such an amendment would empower the directors to consider the interests of stakeholders, i.e. to make it a defence to a complaint that they had acted improperly and not necessarily contrary to shareholder interests (Bill Beerworth, "A modest proposal: recognise the existence of stakeholders", Company Director, December/January 2004-2005 at p.13).

34. There is an argument voiced by Tom Bostock that such an amendment would "require a director to consider corporate social responsibilities [that] will subjugate a board to the politics of trying to balance different interests and stakeholder concerns" (Tom Bostock, "Is Beerworth's proposal really so modest?", Company Director, December/January 2004-2005 at p.16). Here, Bostock queries how to judge stakeholder interests and meet subjective community expectations.

35. However, the Taskforce considers that while the balancing of various interests may be difficult initially, it is necessary in order to address the needs of the greater community.

Regulating corporate responsibility

36. The Taskforce submits that the Act must be amended to include the Australian Securities Investments Commission (**ASIC**) as the main regulator for ensuring directors and entities meet their obligations to the stakeholders and the broader community.

37. ASIC is already the main regulating body that enforces and gives effect to the Act to protect consumers, investors and creditors (see *ASIC Act 2001* s 1(2)(g) and "ASIC at a glance – Our role" link at www.asic.gov.au). They already have the appropriate mechanisms in place, which include extensive powers and functions under corporations legislation, and they are able to commence and conduct criminal and civil proceedings (there are various provisions in place, and most involve preservation of assets). This will ensure that any company which violates a rule of corporate responsibility will face some form of disciplinary measure. ASIC also uses the medium of the media and public publications to keep the public informed ("ASIC at a glance – Our role" link at www.asic.gov.au). This is instrumental in using public pressure to ensure principles of corporate responsibility are being taken seriously and being adhered to by companies.

38. ASIC's investigation and enforcement powers are not limited to the exercise of functions under the *ASIC Act 2001* (Cth). According to its statutory responsibilities and powers under the *ASIC Act* 2001 (Cth) Pt. 3, the ASIC is the principal complaints handling body. They receive complaints from numerous informal sources. This means that the public should feel able to make a complaint, especially as a consumer. The fact that ASIC is an independent Commonwealth government body would ensure that responses would be reasonably fair and uniform. They often initiate investigations at their own motion, especially as a response to media reports or the public interest. The ASIC holds the public interest as a top priority, and this is reflected in how they proceed in their investigations (however, such investigations may not involve the formal powers of Pt. 3).

Directors' duties

39. With reference to Term of Reference (c), legal change to accompany and continue to drive the cultural change taken from the momentum of the Jackson Inquiry and now the CAMAC Inquiry is being seriously contemplated. As discussed, the traditional view of directors' duties, as is captured in the Act, requires a director to act in the best interests of shareholders by maximising profits and not to consider social/environmental concerns outside of that context. In limited situations directors are required to consider interests of creditors (when in insolvency or near insolvency).

40. The Act is clearly the most appropriate framework in which to incorporate corporate responsibility obligations on directors. Australian companies are highly aware of compliance requirements under the Act and the regulator, the ASIC, administers a highly effective regime. Furthermore, the penalties under the Act are more appropriate than those that may be available under various environmental statutes for example.

41. The Taskforce submits (as also discussed in Term of Reference (g)) that a middle measure may be to follow the recent UK Company Law Reform Bill (introduced March 2005). Draft clause B3 of this Bill requires a director to act so as to "promote the success of [their] company for the benefit of its members as a whole", taking into account so far as is reasonably practicable any need of the company "to consider the impact of its operations on the community and the environment" (among other things).

Term of Reference (e)

Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors

Code of conduct

12. The Taskforce’s preferred approach, as set out in our response to Term of Reference (d), is for the Act to be amended to set out a general principle that directors must consider stakeholders' interests.

13. However, an alternative mechanism which may enhance consideration of stakeholders' interests is a code of conduct. The Taskforce proposes a new code of conduct based on existing codes as advocated by the Australian Stock Exchange (**ASX**) and Standards Australia, but with application to all entities regulated by the Act. The Taskforce’s focus however, remains on listed companies and trusts (whether listed on Australian markets or overseas) as the key players in the debate on corporate responsibility.

14. Measures need to be taken with multinationals to ensure that they are bound to the law if they are dealing with Australian retail investors. There are provisions in the Act that cover this, but a specific provision about this and abiding by corporate responsibility principles needs to be included.

15. The Taskforce considers that a largely aspirational code of conduct would provide little guidance to entities without particular industry guidance. Therefore, we suggest a principles-based corporate responsibility code of conduct should be supported by guidelines to be issued from time to time by ASIC (ASIC's power to do this derives from s 1(2) of the *ASIC Act)*. These guidelines will be developed in consultation with industry groups and would have no legal status.

Using an existing mechanism - ASX CGC Principle 10

42. In March 2003 the ASX Corporate Governance Council (**ASX CGC**) released the “Principles of Good Corporate Governance and Best Practice Recommendations”. ASX listing rule 4.10.3 requires companies to disclose in the corporate governance section of the annual report the extent to which they have adopted the 28 recommendations.

43. 2004 was the first year that listed trusts and companies were required to provide disclosure against the ASX CGC Principles and Recommendations. A May 2005 report by the ASX on corporate governance practices reported in 2004 indicates that the average adoption rate for all ASX CGC recommendations for the whole market was 68% and almost 85% for the top-500 companies (ASX, “Analysis of Corporate Governance Practices reported in 2004 Annual

Reports", 16 May 2005). This indicates a clear acceptance of the principles at the board-room level. However, we note that most attention has centred on the form of disclosures against the recommendation, as opposed to the utility of such disclosures as an indicator of actual company performance (in relation to those recommendations).

44. Principle 10 provides that companies should "recognise the legitimate interest of stakeholders". Legitimate stakeholders are defined to include non-shareholder stakeholders such as employees, clients/customers and the community as a whole. Recommendation 10.1 requires a company to establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

45. It includes guidelines for the content of a code of conduct as follows:

clear commitment by board and management to code of conduct;

responsibilities to shareholders and the financial community generally;

responsibilities to clients, customers and consumers;

employment practices;

obligations relative to fair trading and dealing;

responsibilities to the community;

responsibilities to the individual;

how the company complies with legislation affecting its operation; and

how the company monitors and ensures compliance with its code.

46. Such a code of conduct, based on notions of legitimacy, fairness and ethics, is intended to be used to "set the tone and standards of the company" and to "oversee adherence" to such notions.

47. The ASX notes that the virtues of a code of conduct are that they can assist the board in recognising legitimate interests and enable employees to alert management to potential misconduct (ASX CGC Principle 10, p 59).

48. Although the ASX reports that levels of adherence to the ASX CGC Principles are high, the May 2005 report contained little discussion of disclosures made against recommendation 10.1 and no discussion of specific adherence to that recommendation. The ASX directs companies and trusts to Standards Australia's Draft DR03028 *Organisational Codes of*

Conduct, Draft DR03028 *Corporate Social Responsibility* and Draft DR 03029 *Whistleblowing Systems for Organisations* for further guidance on the content of a code of conduct.

Standards Australia

49. The TaskForce notes that Standards Australia's Standard on Governance (AS 8000-2003) also sets out the role of stakeholders in corporate governance. The Standard was drafted for all types of entities (listed and non-listed) and is quite similar to the ASX CGC principles. The TaskForce believes this standard could also provide the basis of a potential code of conduct.

Term of Reference (f)

The appropriateness of reporting requirements associated with these issues

16. Presently, the reporting framework in Australia on corporate responsibility matters is voluntary. Voluntary reporting has resulted in inconsistent, incomplete and biased information. Furthermore, the number of companies reporting on social and environmental matters remains few and far between. Social reporting is particularly worrisome (Doane, D. "Market failure: the case for mandatory social and environmental reporting", New Economics Foundation, available at www.corporate-responsibility.org).

50. The current statutory reporting requirements under the Act and the Australian Accounting Standards (**AAS**) issued by the Australian Accounting Standards Board (**AASB**) require an entity to report almost exclusively on the historical economic or financial performance of the entity during the financial year. (However, refer to sections 299(1)(d) and 299A of the Act.) While there has been a strengthening and extension of disclosure requirements since the introduction of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (**CLERP 9**), there exists opportunity to strengthen the reporting requirements through the mandatory adoption of triple-bottom-line reporting in Australia.

51. Triple-bottom-line reporting is a reporting framework that has been voluntarily adopted by some Australian entities, and generally refers to the publication of an entity's economic, environmental and social performance, in addition to current statutory reporting requirements to disclose the financial or economic information. While there has been some uptake in voluntary triple-bottom-line reporting, there exist strong advantages in providing a mandatory triple-bottom-line reporting framework in Australia.

52. Advantages of mandatory triple-bottom-line reporting include:

providing for a transparent and balanced reporting approach, including requiring information that is both favourable and unfavourable to a corporation's image to be reported;

improving comparability of reporting information between different entities;

allowing information to flow to a broader stakeholder audience;

improving corporate reputation;

allowing the benchmarking of performance and facilitating international competitiveness;

attracting and retaining high-quality employees by demonstration that an organisation is focused on its long-term existence;

increasing access to investors and ethical funds;

providing for sustainability and long-term economic survival;

favourable economic performance (see "Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005);

enforceability;

more simplified processes – by limiting reporting to investors and other stakeholders, mandatory reporting would establish a definable standard for business and minimise transaction costs in responding to various queries relating to social and environmental performance; and

reduction in costs by limiting spin through the production of high-cost PR reports, focusing business on the management issues at hand and including this information tin the annual report to shareholders.

53. Disadvantages of triple-bottom-line reporting include:

increase in annual reporting costs with disproportionate costs to smaller business;

potential exposure to risk and liability in relation to the reliability of the triple-bottom-line report's content (which could be overcome by mandatory auditing of the triple-bottom-line reports);

while there has been some successful voluntary adoption of triple-bottom-line reporting in Australia, studies have indicated that there exists potential bias in the current voluntary presentation of triple-bottom-line reporting in Australia, which has observed the inclusion of information that in some cases is limited to only favourable environmental and social reporting information; and

similarly, the usefulness and comparability of triple-bottom-line reports between different entities has been limited, after studies of disclosures made by a number of publicly listed companies show that disclosures range significantly in content and quality.

54. It is the Taskforce's view that triple-bottom-line reporting should be mandatory for incorporated entities in Australia, since the current reporting requirements and voluntary triple-bottom-line reporting is not adequately achieving meaningful and consistent reporting information for a broader range of stakeholders.

Current reporting requirements

55. Current reporting requirements under the Act and the AAS have the force of law under section 295(2)(a) of the Act. The financial statements and notes are those required by the AAS. In addition, the notes must include any other information that is necessary to give a

"true and fair" view of the financial position and performance of the company (pursuant to section 297 of the Act). The directors' declaration must involve the director declaring whether the financial statements are in accordance with the AAS, and if the "true and fair" view requirement in section 297 primarily focuses on the entity's requirements to report predominantly historical economic performance in the annual financial report and director's report.

56. The requirement in section 297 of the Act is mirrored in the AAS (AASB 101 "Presentation of Financial Statements" (15 July 2004)). Paragraph 13 states:

> [a] financial report shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Australian Accounting Standards, with additional disclosure when necessary, is presumed to result in a financial report that achieves a fair presentation.

57. However, the requirement to provide a "true and fair" view is applicable only to the economic aspect of a company's performance rather than including the broader environmental and social performance envisaged by triple-bottom-line reporting.

58. While there does exist a mandatory requirement to provide some environmental reporting in the entity's annual director's report under section 299(1)(f) of the Act, there has been ambiguity in practice as to the nature and extent of this legislative requirement. The application of section 299(1)(f) is uncertain due to the meaning of particular and significant environmental regulation. It could potentially mean either an environmental regulation, which has particular application only to the reporting entity. Alternatively, it could involve the reporting entity being subject to an environmental regulation, which has general application within the jurisdiction but has "particular" significance to the reporting entity by reason of the nature or extent of its operations:

> The directors' report for a financial year must - if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory – give details of the entity's performance in relation to the environmental regulation.

59. While this requirement appears to require companies to account for their environmental performance, research indicates that disclosure is more common for companies in the materials, capital goods and energy sectors and those that are subject to regulatory regimes, for example, the *Fuel Quality Standards Act 2000*, the *Environmental Protection (Diesel and Petrol) Regulations 1999*, and state environmental legislation such as the *Protection of the Environment Operations Act 1997* (NSW) ("Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005). Furthermore, the research has indicated that the

disclosure practices range in format, quality and scope with some companies providing very little information due to the ambiguity of the extent of environmental reporting that is required.

60. Although some entities are faced with this mandatory environmental performance reporting obligation, there exists little or no mandatory requirement for entities to report information pertaining to social performance.

61. Similarly, there is no requirement in the AAS that the environmental and social information relating to the entity's transactions and events must be reported on in the financial report. AASB 101 "Presentation of Financial Statements" states at paragraph 10:

> Many entities also present, outside the financial report, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group. Reports and statements presented outside the financial report are outside the scope of Australian Accounting Standards.

62. Section D of the KPMG Survey identifies codes, standards and guidelines used in many jurisdictions worldwide. Any mandatory reporting scheme introduced in Australia should have regard to reporting standards in these jurisdictions, with a view to making multinational companies accountable and reporting by these companies consistent. Section 2.4 of the KPMG Survey discusses trends in corporate responsibility reporting by sector. The results clearly show that reporting on corporate responsibility matters varies in each industry sector. Further, the report identifies that disclosure is then often selective and restricted to certain issues.

63. Section 299A of the CLERP 9 has strengthened to some extent the pre-existing reporting requirements (see sections 297 ("true and fair view"), 299(1)(d) and 299(1)(3)), by requiring the annual directors' report for a listed public company to include:

> information that members of the company would reasonably require to make an informed assessment of:
> (a) the operations of the entity reported on; and
> (b) the financial position of the entity; and
> (c) the entity's business strategies and its prospects for future financial years.

64. While this has strengthened the pre-existing reporting requirements, this reporting requirement is not adequate for two reasons:

it has limited application, namely to listed public companies; and section 299A(3) of the CLERP 9 qualifies the requirement in allowing the omission or non-disclosure in the directors' report of the information on "the entity's business strategies and its prospects for future financial years" as required by section 299A(1)(c):

> If it is likely to result in unreasonable prejudice to:
> (a) the company or disclosing entity; or
> (b) if consolidated financial statements are required—the consolidated entity or any entity (including the company or disclosing entity) that is part of the consolidated entity.

65. Therefore, unfavourable economic, environmental and social information can be omitted from the statutory accounts, subject to the mandatory environmental reporting requirement under section 299(1)(f) of the Act.

Product disclosure statements

66. Since 11 March 2004, s1013D(1)(l) and the regulations to the Act [7.9.14C] contain obligations for all investment product issuers to disclose information about labour standards and environmental, social and ethical factors in product disclosure statements (PDSs) of investment products.

67. Section 1013DA of the Act states that ASIC may develop guidelines where a PDS claims that labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.

68. The Taskforce notes that the ASIC has also developed guidelines for the inclusion of information relating to labour standards and environmental, social and ethical factors in PDSs of investment products (ASIC Media and Information Releases "ASIC releases final socially responsible investing guidelines" 17 December 2003). These guidelines stem out of reforms to the Act requiring investment products to disclose this information in PDS.

69. These guidelines are aimed at product issuers in allowing them to determine for themselves particular factors and the methodology involved with labour, social or environmental standards. The Taskforce further notes that ASIC intends to review these guidelines in 2006 (ASIC Media and Information Releases "ASIC releases final socially responsible investing guidelines" 17 December 2003).

Global Reporting Initiative

70. The Global Reporting Initiative Guidelines (2002) are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products or services (a copy of the Global Reporting Initiative Guidelines is available at: www.globareporting.org/guidelines).

71. The presentation of voluntary triple-bottom-line reporting in Australia using the Global Reporting Initiative Guidelines has encompassed one of three forms ("Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005):

an integrated approach whereby the environmental and social information is integrated into the entity's economic performance as disclosed in the entity's statutory annual report, or

a segregated approach whereby the environmental and social information is provided by way of a stand-alone discrete report, or

a combination of the entity including some environmental and social information both in the statutory annual report, and also, on a stand-alone basis.

72. The Global Reporting Initiative Guidelines comprise a total of 40 indicators (16 core environmental indicators and 24 core social indicators). The problem with the Global Reporting Initiative Guidelines is that, like the Australian Public Environmental Reporting (**PER**) Framework, it remains a voluntary scheme. (In March 2000, "A Framework for Public Environmental Reporting - An Australian Approach" was published by Environment Australia in conjunction with the National Heritage Trust. Copies of the PER Framework can be obtained at www/environment.gov.au/epg/environet/eecp/publications.html.) Consequently, companies cannot be compelled to report against its standards. Consistency in reporting is, however, crucial to transparency. It is therefore vital that Australia has regard to the Global Reporting Initiative and to foreign mandatory reporting standards. Foreign standards of particular note include those in the United Kingdom (under the recent amendments to company law, introducing the "Operating Financial Review" (see www.icfconsulting.com/Publications/Perspectives-2004/uk-ofr.asp)) and those in the United States of America (under the *Sarbanes Oxley Act*), which appear to be among the more developed mandatory reporting requirements, even if these standards are not specifically focussed on corporate responsibility.

Barriers to the implementation of mandatory triple-bottom-line reporting

73. It is argued that mandatory reporting may impose a significantly higher compliance burden than would be justified by the principle that mandatory regulation should be the minimum necessary to achieve the set objectives.

74. It is also argued that regulatory provisions might impose additional costs on top of the established regulation, for little or no tangible benefit, with substantial risk of uncertainty and litigation. The risk of litigation arising from misleading disclosures and enforcement action will mean that moves to introduce any mandatory reporting requirements are likely to meet with strong business opposition.

75. Notwithstanding the above arguments, the Taskforce considers that these potential barriers should not be heralded as grounds for not implementing mandatory reporting. Increased costs are a perception only and are likely to be more than offset by risk reduction, increased stakeholder confidence in the reporting entity and costs savings arising from understanding what does and doesn't need to be reported. Costs arising from litigation are likely to be few and far between and enforcement costs are costs that should be properly borne by an entity failing to comply.

Term of Reference (g)

Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia

17. Countries in Europe and to a lesser extent, North America, have designed and implemented numerous initiatives in an effort to promote corporate responsibility both domestically and internationally. Of these initiatives, the Taskforce considers the following could be adopted or adapted for Australia.

European initiatives

France

76. France has been very active in the corporate responsibility arena, particularly through regulatory initiatives which make corporate responsibility an integral part of the workplace and financial market.

77. France mandates triple bottom line reporting for publicly listed companies, by law. The law requires a listed company to state in its annual report how it takes into account the social and environmental consequences of its activities. The law also obliges companies to report on a set of qualitative and quantitative social indicators which have been drawn by decree. However, the law does not prescribe the guidelines for reporting.

78. Similarly, the laws governing public pensions and employee savings plans require the disclosure of social, ethical or environmental criteria used for investment.

79. France also requires companies to report on community issues, including the impact of their activities on local development and local populations, how they engage with local stakeholders such as environmental NGOs, consumer groups and educational institutions. The companies must also report on their overseas subsidiaries and sub-contractors complying with ILO core labour conventions.

Germany

80. Germany has a number of approaches in place in order to encourage the use of corporate responsibility practices by companies.

81. The German federal government offers benefits and incentives to apply a European community scheme called the European eco-management and audit scheme (**EWAS**). EWAS includes agreeing to environmental supervision, reporting requirements, notification

duties regarding corporate organisation and emission measurements. The voluntary scheme was popular with 2600 German EWAS-certified companies in 2004.

82. The German federal government has also set up a website to inform consumers about fair trade, which features the companies, organisations and products in this field. This website demonstrates a practical approach by the government to encourage companies to adopt corporate responsibility initiatives.

83. The German federal government has also signed an agreement with German industry to promote gender equal opportunities in the private sector, such as best practices, advice for companies, and integration of equal opportunities and family friendly policies in training materials and corporate consulting.

84. The German export ministry promotes corporate responsibility-friendly guidelines, namely the OECD guidelines, through its export credit programme. The programme is voluntary and not mandatory.

85. In addition to the above initiatives, Germany has also legislated a requirement for all certified private and occupational pension schemes to report on whether or not they take into account ethical, ecological and social aspects in their investment policies.

United Kingdom

86. The United Kingdom government has set up a website on corporate responsibility. Although it is propaganda driven to some extent, the website actively promotes corporate responsibility and does contain some useful general information.

87. The United Kingdom government has proposed amendments to directors' duties requiring them to take into consideration the interests of a broader range of stakeholders (i.e. not just shareholders). One of the objectives for the current law reform proposal is to provide a legislative obligation upon directors to promote their companies by taking into account factors such as employees, effects upon the environment, suppliers and customers. Page 20 of the Company Law Reform White Paper (March 2005) states that:

> the basic goal for directors should be the success of the company for the benefit of its members as a whole; but that, to reach this goal, directors would need to take a properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and in the community more widely.

88. The *Pensions Act Amendment*, which came into effect in July 2001, requires trustees of occupational pension schemes to disclose the extent to which social, environmental or ethical considerations are taken into account in the selection of investments. This

requirement is similar to the obligations imposed on product issuers under s1013D(1)(l), s1013D(2A) of the Act and 7.9.14C of the regulations to the Act.

89. The *Environmental Information Regulations 2004* came into force at the beginning of this year and requires public authorities to make a broad range of environmental information held by them available to the public. The expansion of this into the private sector in respect of Australian publicly listed companies may be of interest.

Belgium

90. Belgium, like a number of other European Union countries, has introduced a voluntary social label, by law. Under the law, a company can acquire a label as long as it meets a number of criteria and is examined by one of the bodies accredited by the Belgian Minister for Economic Affairs. A company applying for the label for one of its products has to submit information on all suppliers and subcontractors directly involved with the making of the product.

The Netherlands

91. The Dutch government has implemented a number of initiatives to promote the use of corporate responsibility in the marketplace. Among these are:

a “green investment directive” that promotes access to finance for environmentally sound projects, and provides that the returns are exempted from income taxes; and

a requirement that companies applying for taxpayer-funded subsidiaries must declare in writing that they are familiar with the OECD guidelines on corporate responsibility, and that they will make an effort to apply them to their operations. The guidelines are voluntary and compliance with them is not monitored.

Austria

92. Among its many initiatives, Austria has developed a code for its travel and tourism industry which is a code of conduct for the protection of children from sexual exploitation in travel and tourism. The overall project which developed the code includes a training component, a clause in contracts with suppliers, information to travellers and reporting guidelines.

North American initiatives

Canada

93. Canada embraces the use of education and training initiatives to advance corporate responsibility. For example, the Canadian government has designed a broad-based website called Strategis, which provides corporate responsibility-related information to corporations

and consumers. It has also designed tools such as the Environmental Management Toolkit and Sustainability Reporting Toolkit, which educate and train businesses (particularly small and medium-sized) to improve on their corporate responsibility practices.

94. Canada also employs regulatory, economic and voluntary initiatives to advance corporate responsibility. Significantly, all federally regulated financial institutions with capital assets in excess of $1 billion are required to issue an annual Public Accountability Statement which describes their contribution to the economy and society, and all corporations listed on the Toronto Stock Exchange are required to adopt a code of ethics. Corporations also have a choice to register their greenhouse gas emission performance on the Voluntary Challenge Registry, and receive public recognition for it.

95. Canada recognises that its corporate responsibility initiatives will need to evolve over time. It has created a post for the Commission of the Environment and Sustainable Development, to monitor corporate responsibility in Canada. Furthermore, federal departments are required to produce sustainable development strategies every three years and table these in parliament. These actions are designed to ensure that corporate responsibility initiatives are effectively coordinated at the government level.

United States

96. The United States uses regulatory initiatives to increase the amount of information a company is required (or expected) to disclose, in relation to its environmental and social performance.

97. For example, the United States Securities and Exchange Commission requires corporations to disclose actual or contingent environmental costs, such as those relating to site clean-up or remediation and potential claims or penalties. Also, the *Sarbanes-Oxley Act* requires United States listed corporations to disclose whether they have adopted a code of ethics for Chief Executive Officers and senior financial officers to follow, and also requires senior executives to assure the legitimacy of performance reports (by signing off on them).

CONTRIBUTORS

This submission has been prepared on behalf of the TaskForce by:

- Louise Camenzuli
- Joanne Chaina
- Stuart Cork
- Rebecca Dimaridis
- Amelia Dixon
- Jeremy Green
- Carla Koffel
- Janette Kovacic
- Lily Mathews
- Alexandra Milcz
- Revell Norquay
- Kelleigh Rabbitt
- Mariko Ralph
- Hillary Ray
- Anita Roberts
- Davyd Wong

1 March 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

Re: Corporate Social Responsibility Discussion Paper

National Australia Bank Limited is pleased to respond to the request for comments on directors' duties and corporate social responsibility.

The NAB believes that the Australian legislative environment currently provides an adequate framework to allow companies to consider broader stakeholder interests, and that in fact, it makes good business sense to do so. We believe that Corporate Social Responsibility (CSR) helps to create long-term value for shareholders and the communities in which we operate by delivering sustainable business growth and building a great reputation.

We have voluntarily committed to CSR reporting to provide information in an open and honest manner to our stakeholders across a range of social, environmental and economic issues. We believe this is an important element in building trust in our business and that other Australian companies should be encouraged to do so voluntarily. Our approach to stakeholder engagement is demonstrated by our 2005 CSR Report.

To impose a legislative requirement on companies to have regard for the interests of stakeholders will shift the focus from developing innovative approaches to engage their stakeholders to mechanically checking boxes to ensure legislative requirements are complied with.

Further, as CSR reporting is an evolving practice and at an early stage of its development, we believe it is not appropriate for it to be mandated. There is a need for CSR reporting to remain flexible and responsive to the changing and diverse needs of stakeholders and society over time.

We do not believe it is possible to have a 'one size fits all approach' to CSR reporting. However, we do support the development of reporting voluntary guidelines and standards, such as the Global Reporting Initiative's Sustainability Reporting Guidelines.

The GRI Reporting Guidelines assists organisations preparing reports by providing guidance and allowing an organisation to tailor reporting to their particular size, industry sector, resources and stakeholder issues. At the same, it assist readers of reports by ensuring where organisations report on a particular indicator or issue, there is consistency between reporting organisations to aid understanding and comparison.

As an active member of the Australian Bankers' Association, the NAB has also contributed to its submission to the Committee.

For the Committee's information, I attach the NAB submission to the Parliamentary Joint Committee on Corporations and Financial Services, as well as a copy of our 2005 CSR Report, which was released in early December 2005.

Yours sincerely

John Stewart

Dr Anthony Marinac
Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

25 October 2005

Dear Dr Marinac

The National Australia Bank welcomes the opportunity to contribute to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into corporate social responsibility (CSR).

The NAB believes that the Australian legislative environment currently provides an adequate framework to allow companies to consider broader stakeholder interests, and that in fact, it makes good business sense to do so. The NAB has made a public commitment to build trusted relationships with all of our stakeholders – our customers, our people, our shareholders, our regulators, our communities and our suppliers – as part of our (CSR) strategy. The way we approach this is to set an overall Group CSR framework with an annual triple bottom line report, and each NAB region having separate responsibility for developing CSR strategies (refer Appendices). This means that we actively pursue a balanced stakeholder approach.

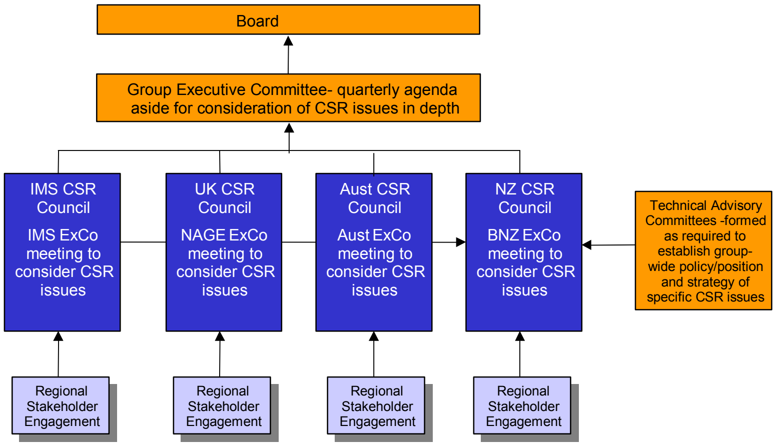
With regard to the terms of reference of the Committee's inquiry, the NAB makes the following points.

a. The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

The NAB has embedded consideration of CSR related issues, oversight of our CSR strategy, and implementation of specific CSR policies and related programs into the formal governance structures and processes of the Group. Our CSR Governance structure is illustrated in the figure below.

This structure reflects our regional business model and gives regional business Executive Committees a clear line of sight and accountability on CSR strategy implementation and regional delivery.

Our Board has the highest level of oversight for our CSR strategy. They review our progress of the strategy on a half-yearly basis and receive papers on other CSR matters from time to time as required.


Board
Group Executive Committee- quarterly agenda aside for consideration of CSR issues in depth
IMS CSR Council
IMS ExCo meeting to consider CSR issues
UK CSR Council
NAGE ExCo meeting to consider CSR issues
Aust CSR Council
Aust ExCo meeting to consider CSR issues
NZ CSR Council
BNZ ExCo meeting to consider CSR issues
Technical Advisory Committees -formed as required to establish group-wide policy/position and strategy of specific CSR issues
Regional Stakeholder Engagement
Regional Stakeholder Engagement
Regional Stakeholder Engagement
Regional Stakeholder Engagement

NAB's CSR Governance Framework

Our Corporate Centre and each regional business have functional personnel specifically dedicated to coordinating and facilitating Group-wide engagement on CSR issues. We also establish Group-wide internal Technical Advisory Committees (TACs) on an adhoc basis to support the development, implementation and review of specific CSR issues. In the past year, we had three operational TACs. One, to conduct a review of our corporate community investment, another to assist in the development of Customer Charters across the Group, and the third to develop our Commitment to Fair International Workforce Standards.

Earlier this year, our Group Operational Risk and Compliance Committee (GORCC) was also given responsibility for oversight and review of corporate social responsibility frameworks and policies. Matters raised by the GORCC in regard to CSR-related risk issues may in turn be brought to the attention of the Group Risk Management Committee and the Board Risk Committee.

b. The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

The NAB is a member of both the Australian Bankers' Association and the Business Council of Australia, and we endorse the comments of those bodies on the extent to which decision-makers have regard for the interests of all stakeholders. The Australian Bankers' Association says in its submission to the current Inquiry:

> "The banking industry is strongly committed to stakeholder engagement as a part of corporate behaviour. […] Banks already have in place comprehensive corporate responsibility activities and stakeholder engagement programs that acknowledge the importance of their employees, customers, suppliers, the environment and the wider community."

The Business Council of Australia writes in its submission:

> "…all Member Companies of the BCA are currently engaged in activities that fall within the scope of 'corporate social responsibility'. Many of these activities involve stakeholders other than shareholders."

c. The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

As stated earlier, we believe that the Australian legislative environment currently provides an adequate framework to allow companies to consider broader stakeholder interest, and that in fact, it makes good business sense to do so.

Under section 181 of the Corporations Act 2001, directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose. Such a duty is not inconsistent with the Board taking into account the interests of stakeholders other than shareholders; in fact, this duty canvases the interests of all stakeholders. The NAB Board has a number of mechanisms in place to ensure that it has direct, line of sight in regard to broader stakeholder interests.

Also as discussed above, the NAB has embedded consideration of CSR related issues, oversight of our CSR strategy, and implementation of specific CSR policies and related programs into the formal governance structures and processes of the Group. Our CSR Governance structure ensures that our Board has the highest level of oversight for our CSR strategy and gives regional business Executive Committees a clear line of sight and accountability on CSR strategy implementation and regional delivery.

d. Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

Any legislation that requires directors to have regard for the interests of specific stakeholders, brings with it an inherent risk of creating a 'tick the box' approach to CSR, where they shift their attention from focusing on how best to engage with stakeholders, to how best to comply with the requirements of the prescriptive law. This would stifle the opportunities for CSR innovation and competition. The ability to increase the range and sophistication of CSR activities is vital.

The NAB also notes the comments made by the Australian Securities and Investments Commission in its submission to the current Inquiry:

> "[Legislating in this area brings with it the potential for] practical difficulties including:
>
> - Difficulties in identifying and defining the various classes of stakeholders that might be considered to have a legitimate claim on the attention and resources of companies.
> - Difficulties in establishing an appropriate hierarchy of stakeholders' interests to resolve conflicting stakeholder claims on the attention and resources of companies.
>
> These potential difficulties would impact on ASIC's ability to successfully enforce the amended provisions."

e. Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

We believe that Government and industry bodies may undertake a number of voluntary measures to enhance the consideration of stakeholders' interests by incorporated entities. These include:

- rewarding and recognising excellence in stakeholder engagement and public reporting;
- raising the awareness of corporations, and business in general, in regard to the drivers and benefits of adopting an approach to doing business which incorporates a philosophy of CSR;
- providing guidance for business, or facilitating opportunities for knowledge exchange between businesses, on the development and implementation of CSR initiatives.

f. The appropriateness of reporting requirements associated with these issues.

CSR reporting is a rapidly evolving area. The NAB believes that reporting and disclosure of our non-financial performance is an important part of building a relationship of trust with our stakeholders and that responsible companies will undertake to do this voluntarily.

CSR reporting is the outcome of actions undertaken by a company with regard to stakeholders, to manage the social, environmental and economic impacts of its activities. In doing this, companies need the flexibility to recognise the key business drivers and issues of importance to their own stakeholders, organisation and industry sector. CSR issues can vary significantly from industry to industry and change over time in response to changing and emerging community expectations and needs. Regulation is slow to change and may create a barrier to the ability of corporations to respond to and report on their operations in the context of these changing societal expectations and needs. Voluntary reporting allows corporations the ability to be more responsive to the needs of their stakeholders.

g. Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

As stated earlier, we believe that the Australian legislative environment currently provides an adequate framework to allow companies to consider broader stakeholder interests. As part of our CSR commitment we have become signatories to, or made public statements of commitment in support of, key finance sector and business programs. These programs include the United Nations Environment Program Finance Initiative, the OECD Guidelines for Multinational

Enterprises and the Carbon Disclosure project. Our commitment to these programs has provided a driver for the development of new policies and programs within the Group. We are also organisational stakeholders of the Global Reporting Initiative (GRI) and we use the GRI Sustainability Reporting Guidelines in the preparing our Annual Sustainability Report. We are active participants in the stakeholder processes used for ongoing development of the GRI Guidelines and sector supplements.

Yours sincerely

John Stewart
Managing Director and CEO

APPENDIX 1

National Australia Bank Group
Corporate social responsibility framework

For the NAB Group, CSR is about making a contribution to sustainable development and society through creating value, both short and long-term, for our shareholders, customers, employees and other key stakeholders. We believe it provides a framework for helping us to operate in a manner that is efficient, customer focused and ethical, and in which our employees are valued, engaged and productive. We believe that CSR must be embedded in our culture and day-to-day business practices. It is the shared responsibility of all businesses and employees within the Group. However, we understand that this is not an easy goal to achieve and that it is a journey we will make over time.

CSR means putting our corporate principles into practice and considering not only the economic, but also the social and environmental impacts of our decisions in a way that maximises benefits and minimises costs for all concerned.

Our CSR framework is linked to the Group's business strategy, which is focused on simplifying the business, delivering sustainable revenue growth, driving cultural change and improving risk management and compliance. Our CSR framework consists of three key components - making balanced decisions, building trust and growing a great reputation.

Our CSR strategy elements at a glance

CSR Strategy Components	CSR Strategy delivery elements
Making balanced decisions	Governance Compliance Monitoring risks and opportunities Managing our social, environmental and economic performance through policies, systems, business processes and programs
Building trust	Stakeholder engagement Disclosure and accountability Meeting our public commitments Reporting on our performance Assurance
Growing a great reputation	Benchmarking and measuring our performance

Public disclosure

The NAB currently uses a range of channels and documents to communicate about its non-financial performance to a varied group of stakeholders from regulators to the general community. The principal mechanisms for disclosure at the NAB are our:

- annual CSR report
- Annual Financial Report and Concise Annual Report
- Community booklet
- Web-based communications.

In 2003, the NAB committed to publicly reporting on its social, environmental and economic performance as a group (Australian, UK and New Zealand operations). We have adopted the Global Reporting Initiative Sustainability Reporting Guidelines (GRI) as for use as our reporting framework, particularly because it is a globally accepted reporting standard. This has included reporting against both the core GRI indicators, as well as the finance sector supplements, which examine sector specific issues. Our approach has been to make incremental improvements in our non-financial reporting on an annual basis.

In December 2004, the NAB published its first CSR report. This report was independently audited in three regions in which we operate. See Appendix 3 for a copy of our 2004 CSR Report.

Web-based communication

The NAB publishes non-financial information on its Group website (www.nabgroup.com). The website includes copies of hardcopy publications as well as more detailed information on our policies and practices. The web is also used to provide ongoing updates on programs, and as a means for providing stakeholders with an opportunity to contacting the NAB on CSR matters.

APPENDIX 2

National Australia Bank
Corporate social responsibility strategy

Our CSR approach

The NAB's approach to CSR is to embed consideration of non-financial issues such as social and environmental impacts into our decision making. Some of the key mechanisms put in place to enable such change to become day-to-day business practice include:

- Our CSR strategy
- External stakeholder forum
- Stakeholder engagement processes
- CSR programs and activities

Our Australian region CSR strategy

Our Australian CSR strategy is focused on areas of direct importance to key stakeholder groups including our employees, customers and the community. In particular this has meant developed our CSR specific programs around four themes:

- inclusive & fair products
- service that benefits the customer
- a rewarding work environment
- meeting our social & environment obligations.

Australian External Stakeholder Forum

Since 1998, the NAB has met with a variety of Australian community leaders to discuss the organisation's performance and community expectations of the way we operate. Over time, the range of stakeholders involved has expanded to include a broad range of stakeholders with interests in broader consumer issues, social disadvantage, small business and environment.

Tim Costello, CEO WorldVision Australia, and Ahmed Fahour, CEO Australia, NAB, chair the stakeholder forum. The Stakeholder Forum meets on a quarterly basis.

Stakeholder engagement processes

In addition to the Stakeholder Forum, the NAB regularly interacts with a wide variety of stakeholders to better understand their expectations as well as to communicate on our performance. Engagement takes several forms:

- Formal membership of committees and industry groups such as the Australian Bankers' Association and Business Council of Australia.
- Partnerships to deliver specific programs and objectives with a variety of community based organisations ie, Good Shepherd Youth and Family Service have worked with us to address the needs of low-income consumers.
- Ad hoc communication/meetings with community, other businesses and government. It is estimated that we respond to over 1,000 different community requests per annum.

Australian region CSR programs

Based on our CSR strategy and engagement processes, the NAB delivers the following CSR programs within Australia.

Addressing financial disadvantage

Over the last five years the NAB has focused its CSR efforts on trying to better meet the financial needs of low-income earners. Much of this work has been done in partnership with the community organisation Good Shepherd Youth and Family Service. Some of the initiatives undertaken to date include:

- Development of affordable banking – for example, a basic bank account with reduced fees for individuals on government benefits.
- Support of the existing community No Interest Loans Scheme (NILS) through funding of the national network administration costs and annual conference.
- Development of Step UP loans - a micro credit product that helps low -income families access a safe and affordable credit option. The Step Up Loans program, which compliments the NILS, is being piloted for two years in five locations. The NAB provides the product, and funds a community-based organisation to manage the customer relationship.
- Training of our Collections Call Centre staff so that they are better able to identify customers experiencing hardship.
- Sponsorship of conferences and events that promote thought leadership in the application of micro-finance in Australia.

Volunteering

The NAB recognises that for community sustainability, it is important to support the work of volunteers. As a result the NAB offers the following programs to both their staff and the community:

- Two days paid leave for all staff to volunteer in the community (over 6,000 days were taken in the last year in Australia). The program is centrally administered to help match staff to community needs.
- Staff volunteer grants – to reward and recognise the involvement of our staff in local community-based organisations. A total of $4,000 is made available every month for these grants.
- National Australia Bank Volunteer Awards. The Awards are in their seventh year of operation with over $2.36 million having been contributed to over 400 community groups since their inception. The focus of the Awards is to reward groups who are able to demonstrate that they are effectively managing their volunteers.

Local community investment

The NAB recognises the importance of connecting its 1200 outlets to their local communities. As such, over $1million is distributed to outlets each year so that they are able to choose which local groups are to be supported. The donations program is often coupled by staff volunteering. In the last year over 2,000 groups were beneficiaries of this program.

Community sponsorship

The NAB supports many community-based sponsorships including:

- Junior Games – a program to encourage the participation of young in sport. The Junior Games, which are part of the NAB's Commonwealth Games sponsorship, have been held in 34 communities and involved 24,000 students over the last year.
- Australian Ballet – a large component of this sponsorship is supporting the involvement of children in ballet. The program specifically supports regional involvement.
- Ovarian Cancer Research Foundation – an awareness campaign to help the Foundation raise funds in order to develop early detection test for ovarian cancer.
- The Australian Football League Auskick program.

Other Australian-based CSR Programs and activities

Increasing our understanding of climate change

This year, with the Victorian Department of Sustainability and Environment, we jointly supported research conducted by Innovest Strategic Value Advisors, to better understand the carbon risks and opportunities being faced by the Victorian manufacturing industry. This research will help inform our work over the next year to further develop our response to climate change, as its shows us the areas where our customers may face climate change risk, and our opportunities to assist them in managing this risk going forward.

Providing project finance

The NAB operates its project finance activities from Australia. The majority of our global project finance portfolio (99.8%) is in high-income OECD countries. The total portfolio represents less than 1% of the Group's total loans and acceptances.

We ensure our project finance customers have taken environmental compliance risks into account and encourage them to consider broader social and environmental risks and to seek and follow expert advice on these matters. We do this in a responsible way that balances our ability to influence improved environmental outcomes with the risk of being seen to become directly involved in a customer's business.

Wherever possible, we are supportive of customers who wish to invest in cleaner technologies. We believe that our approach to project finance can make a positive contribution to improved industry environmental and social performance.

Developing a customer charter

In 2004, we made a commitment to develop a Customer Charter. This year a Group-wide Technical Advisory Committee developed Charter guidelines so that each regional business and our global Institutional Markets and Services business could develop a Customer Charter reflecting the specific needs of their customers. The guidelines were developed after benchmarking Charters produced by other organisations and some consultation with key external stakeholders.

Using these Group guidelines, Customer Charters have been developed for each of our regional businesses and IMS. As a minimum each Charter includes:

- commitments to ensure customers receive the same high standard of service at all times
- the type of service customers can expect to receive from us, how to contact us and provide feedback, particularly if things go wrong
- a commitment to publicly report each year on our performance in line with the Charters.
- weblinks for the regional business Customer Charters are listed on the inside back cover of this Report.

The Australian region Customer Charter is due to be released by the end of October 2005.

Community Booklet

In 2004 and 2005, we released a publication focusing on our activities impacting on Australian communities. This publication, our Community Booklet, is focused on engaging the interest of staff and customers in some of our CSR activities (see Appendix 4).

Web-based communication

The NAB publishes non-financial information on its regional website (www.national.com.au/Community). The website includes copies of hardcopy publications as well as more detailed information on our policies and practices. The web is also used to provide ongoing updates on programs, and as a means for providing stakeholders with an opportunity to contacting the NAB on CSR matters.

Coles Myer Ltd.
ABN 11 004 089 936

R H Allert AM
Chairman

23 February 2006

Mr John Kluver
Executive Director
Australian Government Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Corporate Social Responsibility Discussion Paper

On behalf of Coles Myer Ltd, I appreciate the opportunity to contribute to the Australian Government Corporations and Markets Advisory Committee Corporate Social Responsibility Discussion Paper.

While we believe our key responsibility is to take care of the interests of our shareholders we also acknowledge our responsibilities to other stakeholders – customers, team members, suppliers and the communities in which we operate.
Corporate responsibility is integral to how we do business, how we treat people, local communities, suppliers and the environment.

At Coles Myer we see corporate social responsibility as having four important areas of focus: corporate governance, the workplace and our people, the community and the environment.

At Coles Myer we have established a Board sub-committee to oversee the development of a corporate responsibility strategy, risk assessment and the implementation of our corporate responsibility programs.

In October 2004 Coles Myer published the "Taking Stock" report, the first step in corporate social responsibility reporting. The Corporate Social Responsibility report for 2005 was published as an insert into the Coles Myer Ltd Annual Report. This report highlighted the progress we made during year, as well as new initiatives.

Please find enclosed two copies of the 2005 report for your interest.

The area of Corporate Social Responsibility is diverse and complex. Due to the diverse nature of Australian business we at Coles Myer believe it would be extremely difficult to develop appropriate legislation and reporting standards. The regulation would be very high level and vague and thus unenforceable or so industry specific that it will be highly complex and prescriptive.

Coles Myer is committed to behaving responsibly every day and in every aspect of our business. We acknowledge that Corporate Social Responsibility is an important contributor to our long-term business success and we will continue to achieve results in this area without regulation or a legal necessity to do so.

Yours sincerely

Chairman

cc: Jill Moodie, Corporate Social Responsibility Manager

RepuTex®
Ratings & Research Services

3 March 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

Re: Corporate Social Responsibility - Discussion Paper

Dear Mr Kluver,

RepuTex Ratings and Research Services is pleased to provide a response to the Corporations and Markets Advisory Committee Discussion Paper on Corporate Social Responsibility.

RepuTex is an independent private company engaged in the provision of quality research and ratings services in the area of Corporate Social Responsibility (CSR) and reputation. The company has an extensive knowledge of the CSR market in Australia and Asia. In the Asia Pacific region RepuTex is the pre-eminent leader in the provision of Social Responsibility Ratings and other reputation related research services.

RepuTex has chosen to address a number of issues raised in the Discussion Paper and also directs the Committee to our submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility.

Please do not hesitate to contact me if you would like to discuss further the issues and recommendations raised in this submission.

Yours sincerely

Philip Cohn
Associate Director - Research
RepuTex Ratings & Research Services
PH: 613 9654 7099
FAX: 613 9654 7570
philip.cohn@reputex.com.au
www.reputexgroup.com

In responding to the CAMAC Corporate Social Responsibility Discussion Paper (November 2005), RepuTex refers the Committee to our submission to the Parliamentary Joint Commission (PJC) on Corporations and Financial Markets which should be read in conjunction with this paper.

In concluding the submission to the PJC, RepuTex advised that the following measures may enhance consideration of stakeholder interests by incorporated entities and/or directors:

1) Greater co-ordination between government departments and agencies in order to expand the government's current approach to CSR which has traditionally been limited to community partnerships and philanthropy;
2) Development of a CSR specific ministerial portfolio to oversee effective implementation and encourage greater uptake of existing voluntary mechanisms;
3) Government to take a leadership role:
  3.1 By ensuring that its departments, authorities, and agencies all meet acceptable CSR standards;
  3.2 By supplementing existing guidelines and requirements for tenders and supply agreements to include satisfactory CSR standards;
  3.3 By promoting multi-stakeholder initiatives, e.g. the Global Compact, and encouraging incorporate entities to formally supporting established norms and instruments; and
4) Strengthening of regulatory frameworks to adopt mandatory triple bottom line reporting.

RepuTex contends that reform of the *Corporations Act* merely to provide safe harbour for company officers who engage in CSR is unwarranted. While strict interpretation of the law suggests that Australian directors must give exclusive consideration to advancing the financial, not social or moral interests of shareholders, in practice given the tangible and intangible benefits associated with CSR activity, any perceived illegality of CSR is mistaken, and therefore granting safe harbour is unnecessary. Undertaking CSR as a risk management tool, is by its nature in the best interests of the corporation. RepuTex does however support an expansion of directors duties in order to better promote CSR and sustainability principles, for example via the implementation of mandatory reporting requirements.

RepuTex would like to comment specifically on the CAMAC Terms of Reference that question:

- *How might corporate responsibility be usefully described for working purposes?*

It is RepuTex's contention that Corporate Social Responsibility (CSR) has historically been ill-defined in the Australian context. This has led to confusion among sections of the business community, regulators and key stakeholders which has ultimately skewed debates concerning the merits of effective CSR strategies.

This stems from the perception in some quarters that CSR is merely profit sacrifice via the improvement of various social ills. In practice the adoption of CSR has a much wider application and may be more appropriately defined as a form of risk management. From this perspective:

> Corporate Social Responsibility (CSR) is best defined as a management tool or strategy which organisations can employ to address key governance, environmental, social and workplace risks, while capitalising on opportunities which add value to the organisation and its stakeholders.

- *What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?*

There are clear incentives for a company to 'conduct its business in a socially responsible manner' as suggested in the above definition.

In recent years RepuTex has seen a shift as leading organisations both in Australia and internationally have begun to appreciate the positive implications of 'sincere' CSR and recognise the fundamental importance of addressing stakeholder concerns to both the long-term viability of the corporation and the community. As the concept is further developed – and adopted as a mainstream management tool – it is expected that CSR strategies will be more widely adopted to drive innovation and enterprise value as well as incorporated into operational risk management procedures as competitive pressures drive take-up due to the benefits of an integrated approach. Evidence of this can be seen in the incremental improvement in performance of Australian and New Zealand companies in the RepuTex Social Responsibility Ratings between 2004 and 2005.

Nonetheless disincentives remain an impediment to full scale take-up of CSR across the Australian market. This can be attributed to a number of key factors:

i) Not all companies recognise the business case for CSR or perceive issues linked to governance, environmental, social or workplace factors as an immediate material risk to the company and its shareholders.

ii) There remains a focus on short-term indicators, eg. share price, at the expense of the long-term sustainability of the company. In sections of Australian corporate culture this tends to hinder the ability of some corporate decision-makers to recognise long-term costs and externalities.

iii) While the Federal Government has actively promoted CSR through the Prime Minister's Community Business Partnerships (PMCBPs) there has been a lack of coordination between government departments and agencies to nurture the mainstreaming of CSR. Greater governmental coordination and advocacy has thus far occurred in other jurisdictions such as the United Kingdom where CSR has moved from a fringe activity to one increasingly seen as a mainstream corporate governance tool used by directors of publicly listed companies and government owned enterprises.

- *Do different or additional implications arise depending on the nature and size of the enterprise?*

While 'different or additional implications arise depending on the nature and size of the enterprise' certain sectors continue to lag behind others in their efforts to integrate CSR into their operations. Research by RepuTex indicates that companies in sectors including Banking and Materials have tended to more readily adopt strategies which address key social risks and maximise associated opportunities, while other sectors such as Media, Hotels and Leisure have tended toward a compliance based approach.

There are obvious reasons for this. Industries such as Banking have been subject to significant stakeholder scrutiny stemming from a perceived lack of concern for the communities in which they operate. This has led some Banks to become CSR leaders in Australian (and global) markets. Similarly companies in the Materials sector, particularly the extractive industries, have attempted to adopt a more sustainable profile following various NGO and social movement actions around issues stemming from environmental degradation and indigenous rights.

Cynics may argue that these organisations are attempting to placate their critics and remain wedded to irresponsible practices. However it is increasingly recognised that CSR has matured beyond its early public relations phase and can be seen as a new way of doing business. It creates competitive advantage through driving efficiency, innovation, lifting employee, productivity/quality/retention and enhanced enterprise value through maximisation of human, reputation and social capital. These are benefits that than can accrue to any organisation, and while a company's approach will invariably be influenced by the nature of its operations and the sensitivity of the markets in which its operates, it can be argued that CSR remains an integral business strategy.

- *In practice, to what extent is corporate decision-making driven by stakeholder concerns?*

Clearly decision-makers make distinctions between different classes of stakeholders. Nonetheless, as noted above, leading corporate entities recognise the benefits of managing broader stakeholder expectations and the benefits that this can have on shareholder value. These include an enhanced capacity to manage and control risk associated with new or altered demands from corporate regulators, employees, the community, shareholder activists and consumers, and ultimately, the long-term preservation of the communities in which they operate. From this perspective recognising stakeholder concerns is an emerging business imperative, but it should be noted that corporate decision-makers do not uniformly prioritise stakeholder interests.

- *In practice to what extent do stakeholders consider a company's social responsibility performance when making assessments about a company?*

Again distinctions remain between different stakeholders and the nature of the company's business. However RepuTex has seen a range of internal and external stakeholders – be they investors, consumers, community groups or employee publics – gradually take a greater interest in the extra-financial aspects of a company's operations. This interest will invariably gather pace as the corporation assumes a more prominent role in society. We have already seen NGOs and other pressure groups monitoring the activities of corporate entities and often basing their assessments about a company on its performance against defined social and environmental targets. Yet, in recent years this has moved beyond the interest group sphere to include individuals, potential employees, supply chain partners and increasingly, investors.

The most cogent example of this is the growth in the Socially Responsible Investment (SRI) market. We have seen a steady increase in the number of investors who look to non-financial concerns when making investment decisions. This shift has been driven by an increasing awareness of issues such as environmental degradation, social and economic inequality and human rights abuses, coupled with a growth in financial literacy. Such investors now account for a growing proportion of the investment market in Australia and as of June, 2004 there was over AUD$21 billion in Funds Under Management (FUM) in SRI products. While this clearly remains a comparatively small proportion of overall FUM, many in the investment community anticipate that SRI will make a move into the financial mainstream within the next decade as increasingly savvy and informed investors allocate superannuation payments to SRI products. Indices, such as the RepuTex SRI Index, are a further reflection of this trend and play an important role in providing information to investors, while sending a signal to companies about the importance of CSR.

Similarly there is evidence to suggest that employees are increasingly taking into account the social and environmental profile of potential employers. This is acting as a key driver of CSR take-up within Australian companies as they strive to attract and retain talent in increasingly competitive and globalised labour markets.

- *Are there any changes that could enhance triple bottom reporting, sustainability or like reporting including:*
  - *whether any aspect of this reporting should be mandated and, if so, for what companies and what respect(s)*

In encouraging non-financial reporting, governmental support is crucial and a consistent approach needs to be taken to ensure that reports are both adequate for stakeholders and comply with legal requirements. The Global Reporting Initiative (GRI)'s sustainability reporting guidelines are perhaps the most globally applied reporting standards and Australian companies should be encouraged to utilise the G3 guidelines (to be released in October 2006) in the preparation of their sustainability or Triple Bottom Line reports (TBL).

The current situation in Australia where companies' main environmental disclosure requirements are the National Pollutant Inventory and the *Corporations Act s 299(1)(f)* has resulted in a situation where stakeholders cannot always accurately compare the performance of two similar companies due to different approaches taken to the reporting of non-financial information and different understandings of what consists a 'particular and significant environmental regulation'.

Comparisons are further complicated when contrasting social performance indicators. Few companies have adopted uniform standards by which social performance can be reported creating issues for stakeholders, external assessors and ratings agencies. While it is often more difficult (and contentious) to quantify a company's social performance which is largely a qualitative exercise, it has become evident that Australian companies have fallen behind their OECD counter-parts.

It is RepuTex's contention, therefore, that the Federal Government should implement mandatory TBL reporting for listed companies. Some critics have put forward the argument that mandatory reporting would promote a compliance based approach. They note further that this would stymie innovation and lead to a 'tick box' culture. However it is RepuTex's contention that mandatory reporting – particularly if material risks were effectively factored into disclosures – would create competitive pressures that would lead to innovation as organisations attempted to outperform sector and market peers. Moreover, at its most basic level reporting would require companies to consider the impact, positive or otherwise, that their operations have on the community. This requirement for heightened transparency would potentially act as a driver for companies to develop systems to capture data on their performance and introduce strategies to manage and mitigate their impacts.

- *increasing the level of clarity and comparability of these reports* –

There is a need to promote a greater degree of consistency and comparability between CSR, TBL or sustainability reports. Globally recognised benchmarks such as the GRI offer a useful model which balances the need for flexibility while promoting a globally uniform approach. Where implemented effectively benchmarking against GRI indicators also enables stakeholders to efficiently establish the CSR profile of a particular entity.

- *any suggested changes to external verification of those reports*

There is clearly a space for mandating independent verification of CSR reports. As noted in the Discussion Paper there is a perception among sections of the community that CSR reports can become instruments of 'Greenwash' as companies attempt to fashion reports as brochures or extensions of PR campaigns. Verification by established auditing firms and consulting companies adds credibility and integrity to these reports, and where conducted by an independent, third party, an additional layer of accountability.

- *To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?*

As outlined in the Discussion Paper, 'voluntary initiatives by their nature lack sanctions, other than peer or market pressure'. RepuTex acknowledges that there is a growing recognition that voluntary initiatives without adequate government support are insufficient in promoting CSR, and has found that corporate Australia's environmental and social performance has not significantly improved through voluntary mechanisms, although there has been an incremental improvement over time as innovative companies push forward.

A case in point is the target for Australian retailers to voluntarily phase out plastic bag usage by 2008. Rather than following the lead of Ireland in placing a levy on plastic bags – which resulted in usage being cut by 90% in the first five months alone[1] – the Australian Retailers Association and major retailers lobbied instead for a voluntary reduction plan. Under the plan, group one companies (including Coles, Woolworths and Kmart) set a target of 50% reduction by December 2005 (using 2002 figures as the baseline). However as of July 2005 participating retailers had managed only a 33.8 per cent cut, prompting calls for a mandatory levy to be reconsidered.

Another example of Australia falling behind others on the global stage is in the area of greenhouse gas emissions. While Australia is admittedly on schedule to meet its Kyoto target (despite not ratifying the Protocol), it should not be forgotten that Australia is in fact the only developed country allowed to increase its emissions over 1990 levels. In comparison to the European Union, which (in part through its use of financial incentives to reduce emissions) reduced its 2003 total emissions by 1.7% below the baseline[2], Australia's 2003 total emissions increased 1.1% over the baseline levels[3].

The lack of sanctions and/or mandated mechanisms to reduce emissions, such as the development of national carbon trading schemes, has significantly influenced the degree of action by companies to reduce greenhouse gas emissions in Australia. The lack of governmental support for significantly increasing the mandatory renewable energy target (MRET) can also be considered a major factor in the lack of innovation shown by utilities companies in investing in renewable energy developments and technologies.

- *What lessons might be derived from any experience with voluntary initiatives?*

Beyond mandating CSR reporting, RepuTex recognises that voluntary mechanisms – particularly those that rely on market-based instruments – remain the only feasible solution to broader take-up of CSR across the Australian market. The Federal Government could promote enhanced environmental performance of corporate entities through regulatory support of specific actions such as emission reductions as indicated above. Similarly it can continue to actively promote a culture of corporate giving through the PMCBPs which will gradually lift the philanthropic performance of Australian companies. However voluntary initiatives which lack adequate governmental support will not in themselves encourage the development of a sustainable corporate culture.

Recommendations

It is therefore our contention that government should take a leadership role. It needs to promote enabling policies which support CSR among Australian corporations. In this respect, RepuTex believes that there are a number of voluntary or market based options which would alleviate the need for overly prescriptive regulatory measures. These require commitment from both the public and private sectors:

1) *A whole-of-government approach to CSR*. Where not constrained by conflicting policy objectives governmental bodies should become CSR leaders. There is already evidence that this is taking place with GBEs performing well in the RepuTex Social Responsibility

[1] See for example http://news.bbc.co.uk/1/hi/world/europe/2205419.stm
[2] http://themes.eea.eu.int/IMS/IMS/ISpecs/ISpecification20040909113419/IAssessment1118392868101/view_content
[3] http://www.greenhouse.gov.au/inventory/2003/index.html

Ratings relative to listed and privately-owned entities. However there is a space for greater information exchange between governmental bodies and coordination of policy objectives with respect to CSR. Similarly there is a need heighten the profile of CSR in the broader community and the private sector. The PMBCPs, while commendable, do not retain the profile required to fully mainstream CSR. RepuTex suggests examining the approach taken by the United Kingdom's Department of Trade and Industry and establishing a Ministerial portfolio with oversight of CSR policy.

2) *Introduction of ethical sourcing or CSR supply chain mandates by governmental bodies.* To reward sustainable business practices governmental bodies could implement policies which specifically stipulate that partners and contractors that meet high CSR standards (e.g. across governance, environmental, social and workplace practices areas) should be rewarded with preferential access to contracts and tenders.

3) *Promotion of the SRI market in Australia.* The growth of socially responsible investing – and the signals this sends to corporate decision-makers – offers perhaps the most important driver of CSR take-up across the Australian market.

4) *Mandatory CSR reporting.* RepuTex recognises that there are strong arguments in favour of maintaining the current policy mix of promoting voluntary measures and strategic partnerships through the PMBCPs. However while RepuTex supports an approach which favours market mechanisms and self-regulation we believe that mandatory reporting would help lift the CSR performance of Australian companies and heighten transparency of extra-financial and material risks.

Corporate Social Responsibility

A Submission to the
Australian Government
Corporations and Markets
Advisory Committee

24 February 2006

Chamber of Commerce
and Industry
Western Australia

Table of Contents

Overview **1**

About CCI 1
Introduction 1
Executive Summary 2

Specific Responses to the Terms of Reference **4**

Background **8**

CSR Defined 8
The Role of Corporations 8
The shareholder-oriented firm *8*
The stakeholder-oriented firm *9*
Reasons for Adopting a Stakeholder Orientation 10
Good Behaviour is Profitable *10*
Bad Behaviour is Costly *12*
Trends in CSR 13
Current Practices 14
Example: BHP Billiton *15*

Issues in Relation to CSR **17**

Conflicting Priorities and Values 17
Accountability and Governance 17
The Wider Case Against Regulation 21
Public and Private Regulation *21*
Profiting from Corporate Social Responsibility *21*
Alternative Measures to Regulation 23

Appendix A: Terms of Reference **25**

Appendix B – ASX Best Practice Principles **27**

Appendix C – GRI Guidelines **28**

"In Accordance" Requirements 28
Report Content 29
Environmental and Social Performance Indicators 30

Notes and References **31**

Bibliography 31
Comments and Notes 31

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Overview

About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

Introduction

Recent years have seen renewed focus on the social and environmental dimensions of economic activity, and in particular on the activities of the business sector. This focus has many sources and strands.

It derives in part from the search for new ways of moulding society and the economy in the aftermath of the collapse of communism, and consequent discrediting of state-directed, centralised political and economic models.

It reflects concerns about the processes and effects of globalisation, and the way in which economic decisions and their social and environmental effects increasingly transcend traditional national and regional political jurisdictions.

It is driven in part by the increasing prominence and claims of non-government organisations seeking to fill some of these gaps in authority with the influence of ‘civil society’.

This prominence has in turn been both a cause and an effect of a shift in public opinion towards concerns for the social, cultural and environmental consequences of economic activity.

Within this broad context, the Corporations and Markets Advisory Committee (the Advisory Committee) has been asked to consider the following questions:

1. Should the Corporations Act be revised 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?

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2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Further details regarding the terms of reference to the inquiry can be found at Attachment A.

In addition to this current inquiry, the Parliamentary Joint Committee on Corporations and Financial Services is currently completing its inquiry into Corporate Responsibility and Triple Bottom Line reporting. It is endeavouring to determine the extent to which organisational decision-makers have and should have regard for the interests of stakeholders other than shareholders, and the broader community for profit and not-for-profit incorporated entities under the Corporations Act. CCI provided a submission to this review in September 2005.

The Hon Senator Ian Campbell, Minister for the Environment, has also asked the Australian Stock Exchange (ASX) Corporate Governance Council to consider developing a non-compulsory standard for sustainability reporting for listed companies.

This submission has been structured in four main sections. The first section provides a brief response to each of the broad terms of reference questions detailed above. The sections that follow provide a more detailed analysis of the issue of corporate social responsibility, and in the process provides support for the responses to the questions detailed in the first section.

Executive Summary

The appeal of corporate social responsibility, triple bottom line accounting and stakeholder entitlements among businesses is strong. Some corporations have displayed willingness, and even eagerness, to abandon a shareholder orientation in favour of a wider focus.

Under headings such as triple bottom line accounting, corporate social responsibility, stakeholder capitalism and ethical investment, many businesses are incorporating environmental, social, stakeholder and ethical dimensions of their activities into core objectives along with shareholder returns.

To a large extent, this represents a commercial necessity for businesses to recognise and respond to developments in their operating environment as opposed to a need to respond to regulatory requirements.

For example, the rise in stakeholder orientation among firms is likely to represent the fact that its absence is being more heavily penalised by a community becoming more concerned about the behaviour and ethics of businesses.

The commercial incentive is not purely to avoid negative outcomes. Many businesses have implemented triple bottom line accounting and achieved improvements in operating efficiency or savings in input or waste management costs.

These measures are adopted by firms because they make good business sense and are in the interest of shareholders. It is not appropriate to encourage decision makers to accommodate stakeholder interests beyond this via the regulatory framework.

This is because stakeholder policies beyond those which maximise shareholder returns have the potential to create costly and inefficient outcomes. For example, if business is obliged to further the interests of the community, society, government and environment as well as owners, a range of conflicting questions arise such as which groups and interests are entitled to consideration in how the business is run? And by what means is that consideration to be put into practice?

Even if these questions of entitlement can be resolved, harder problems of accountability remain. Giving other stakeholders real influence over how a corporation operates would require an entirely new framework of corporate accountability and sanctions.

It would rewrite property rights and constrain freedom of choice, redefine corporate governance and transparency, and require new institutions of political, social and commercial accountability.

An overarching concern for CCI is that stakeholder entitlement and related ideas appear to be based on a profound misunderstanding of how modern businesses and economies operate.

It assumes that good results can only come from good intentions – that business activity will only benefit society, the community, the economy and the environment if that is what business leaders (or regulators or stakeholders) set out to achieve. But this is not the case.

A market economy - in which the production, distribution, pricing and use of goods and services are primarily determined by people’s purchasing decisions - leads to a better social and economic outcome than one in which well-intentioned business leaders or regulators try to second-guess people’s wants and needs.

Government already has a role in shaping the regulatory environment where good business practice alone might not result in efficient social and environmental outcomes. Extending social policy objectives to corporations is not in the public interest. It moves corporations into the sphere of public policy and service provision, which is not the role of business.

Specific Responses to the Terms of Reference

Responses to the questions detailed in the terms of reference are provided below. Supporting information is provided in the subsequent sections of the submission.

Should the Corporations Act be revised 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?

Effective decision making requires businesses, and more specifically directors, to take into account the interests of specific classes of stakeholders and the broader community. The current regulatory framework already ensures that social and environmental considerations are taken into account when making business decisions.

In relation to the Corporations Act, no restrictions exist which would prevent directors from taking these considerations into account. Directors have a duty to act in the interest of their company, and therefore must take into consideration the needs of employees, consumers and other stakeholders.

Providing a more formalised duty to external stakeholders would in effect create uncertainty and mean that directors would need to consider those interests alongside the business rather than in the context of the viability of the business. This would also create a subjective assessment of the primacy of interests resulting in an increased risk aversion in commercial decisions.

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

CCI believes that law changes to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions to be unnecessary.

CCI does not believe there is evidence that directors feel that their duties prevent them from taking into account the interests of stakeholders other than shareholders, to the extent that those interests are relevant to the company and its shareholders. Only if there is clear evidence that directors do feel so prevented, and that their views have some legal foundation, should consideration be given to an enabling provision in the Corporations Act that makes it clear that the duties of Directors and officers do not preclude them from having regard for the interests of stakeholders other than shareholders, to the extent that those interest are relevant to the corporation.

As such, CCI is opposed to the view that that the law needs to be changed to "*require directors to take into account the interests of specific classes of stakeholders or the broader* *community when making corporate decisions*". Such legislative intervention is not only unnecessary, but would also be counter-productive.

In the absence of legislative intervention, businesses are already engaged in a wide range of corporate social responsibility activities, and are voluntarily reporting their performances in these areas and subjecting themselves to independent auditing and rating. The increasing trend towards corporate social responsibility is examined in more detail in *Trends in CSR* on page 13 and *Current Practices* on page 14.

If, however, a legislative requirement is put in place to require directors to take account of the interests of specific classes of stakeholders or the broader community when making corporate decisions, there will be a danger that directors will find themselves having to balance competing and conflicting legal obligations. The issues in relation to conflicting priorities and accountability are examined in more detail in *Issues in Relation to CSR* on page 17.

Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

As highlighted in *Trends in CSR* on page 13 and *Current Practices* on page 14, Australian companies are increasingly adopting socially and environmentally responsible business practices.

They do so because these factors need to be taken into account as part of their day to day decision making. For example, the rise in stakeholder orientation among firms is likely to represent the fact that its absence is being more heavily penalised by a community becoming more concerned about the behaviour and ethics of businesses.

However, the commercial incentive is not purely to avoid negative outcomes. Many businesses have implemented triple bottom line accounting and achieved improvements in operating efficiency or savings in input or waste management costs. These measures are adopted by firms because they make good business sense and are in the interest of shareholders.

This issue is further examined in *Reasons for Adopting a Stakeholder Orientation* on page 10.

Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Australian companies are governed by the Corporations Act, the purpose of which is to regulate the formation, operation and closure of corporations and the role of directors and officers. Its purpose is not to set environmental or social standards, nor require a company to behave in a particular way.

Where there is a need to establish minimum standards of behaviour or to prescribe certain types of behaviour, this is appropriately dealt with in specific purpose legislation. In this regard, Australian companies are governed by a large range of legislation, including environmental, financial services, human rights, equal opportunity, sex and racial discrimination, industrial relations, native title, occupational health and safety, taxation and trade practices and fair trading.

In the absence of specific requirements set out in the Corporations Act, businesses are already engaged in a wide range of corporate social responsibility activities, and are voluntarily reporting their performances in these areas and subjecting themselves to independent auditing and rating. The increasing trend towards corporate social responsibility is examined in more detail in *Trends in CSR* on page 13 and *Current Practices* on page 14.

If business is obliged to further the interests of the community, society, government and environment as well as owners, a range of questions arise:

- Which groups and interests are entitled to consideration in how the business is run?
- By what means is that consideration to be put into practice?
- Are all identified stakeholders given equal weight?
- How are inevitable conflicts between the interests of stakeholders to be resolved?
- How are new and changing interests to be incorporated into the business plan?

Even if these questions of entitlement can be resolved, harder problems of accountability remain.

Accountability requires a right to information, authority (the right to issue instructions) and sanctions (the right to impose penalties is those instructions are not carried out). In a typical corporation, directors are accountable to shareholders, while employees and other agents are accountable, through managers, to directors.

If shareholder value were no longer the key objective of management, a new structure of accountability would be needed to determine which interests are entitled to influence how the business is run, who is to decide when that entitlement has been breached, what sanctions are to apply, and to whom.

Such a structure would not be compatible with shareholders' rights to buy and sell shares and to sack directors. For as long as those rights exist, boards will accord special priority to shareholders' interests. Giving other stakeholders real influence over how a corporation operates would therefore require an entirely new framework of corporate accountability and sanctions.

It would rewrite property rights and constrain freedom of choice, redefine corporate governance and transparency, and require new institutions of political, social and commercial accountability.

The virtues of modern businesses are induced and reinforced by the incentive and accountability structures under which they currently operate.

Businesses generate returns for investors by providing customers with the goods and services they want, at prices they are prepared to pay, while proving trustworthy and responsive enough to earn repeat business. In the process, they must secure and develop mutually beneficial relationships with employees, clients, and suppliers.

They create jobs, bid up wages, pay taxes, and innovate in the perpetual search for an advantage over competitors. All of this contributes far more to society than pious good intentions.

Businesses will continue to monitor and respond to changes in the climate of opinion on social, ethical and environmental issues, as they always have.

But to seek to reinforce this process by imposing vague and inconsistent social and environmental obligations on corporations though legislation, disclosure requirements or contractual terms would create a confusion of inconsistent entitlements and undermine accountability.

The issues in relation to conflicting priorities and accountability are examined in more detail in *Issues in Relation to CSR* on page 17.

Background

CSR Defined

There is no single commonly accepted definition of corporate social responsibility (CSR). Some examples of definitions include:

> *"Corporate Social Responsibility (CSR) refers to a range of practices that a business might adopt to ensure that it operates in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business."*
>
> From 'Taking The First Steps: An Overview Of Corporate Social Responsibility In Australia' NSW State Chamber of Commerce, February 2001, p. 5.
>
> *"Corporate social responsibility is essentially a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment."*
>
> From 'Promoting a European framework for corporate social responsibility', EU Green Paper, July 2001, p.5
>
> *"Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large"*
>
> From 'Corporate social responsibility: making good business sense' World Business Council for Sustainable Development, January 2000.

CSR is linked to (and in some cases used interchangeably with) related terms and ideas such as corporate sustainability, corporate citizenship, corporate social investment, the triple bottom line, socially responsible investment, business sustainability and corporate governance.

The Role of Corporations

The debate over corporate social responsibility concerns the role of corporations. For as long as businesses with limited liability have existed, there has been debate about how they should be owned, operated, regulated and motivated. Essentially, there are two differing views of the firm in the context of this issue.

The shareholder-oriented firm

In Australia, the UK and the USA, the commonest understanding of the firm is of a shareholder-oriented institution. This is typically a limited liability joint stock company whose core function is seen as generating profits for its owners.

In this model, corporate governance focuses primarily on ensuring that managers and directors exercise responsible stewardship of shareholders' funds. There is no expectation that these agents have a responsibility to serve any other interests besides those of the people whose property they manage.

Most exponents of a shareholder-focused model of the firm recognise that it is appropriate to modify the behaviour of business owners, managers and directors in the light of the wider social costs and benefits their businesses' activities engender (although the extent of appropriate intervention is hotly debated).

So, firms' operations are constrained within a framework of laws designed to enforce protections for the interests of customers, employees, other businesses, the environment, the community, the government, and so on.

Under this shareholder-oriented model, these constraints are external. No more is expected of businesses than that they obey the rules as they go about their core function of generating profits.

This limited expectation can be expressed either negatively or positively.

Positive advocates of the shareholder-oriented firm assert that maximising profit within a framework of laws is both the most ethically appropriate behaviour of business managers and the most socially desirable, because it leads to the best economic and social outcomes.

This view has been stated by Milton Friedman, who argued 40 years ago that:

> "… there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[i]

The negative view of shareholder orientation presumes that corporate ethics is an oxymoron. In this view nothing better than greed can be expected of business operators and pursuit of owners' interests will be at the expense of the wider community, so a system of laws and regulations is necessary to force corporations to behave according to the community interest.

An oft-quoted observation from 18th century British jurist Edward Thurlow sums up this view summarising the hopelessness of expecting unselfish behaviour from business:

> "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"[ii]

The stakeholder-oriented firm

The model of the shareholder-oriented corporation operating within a framework of rules has never been universally welcomed or accepted, nor has it always been applied.

Social democratic and corporatist societies have enlisted business along with labour and government in a concerted effort to achieve some wider social and economic good – broad macro-economic management or more specific objectives such as limiting wage increases in order to control inflation or reduce unemployment, for example.

Recently, there has been a revival in centre-left political circles of interest in broadening the orientation of businesses' objectives as part of a wider approach to economic management.

This has coincided and overlapped with developments in stakeholder theories of management, which argue that the activities of businesses (and government and non-government agencies) should be oriented towards furthering the interests of a range of social and economic groups, or "stakeholders".

These theories promote what Elaine Sternberg[iii] has described as "entitlement stakeholders".

Some advocates of a stakeholder-oriented approach to the corporation in fact hold very similar opinions to the negative view of the shareholder-oriented firm. They see businesses as inherently anti-social and greedy, and therefore in need of extensive legal and regulatory restraints to make them give due consideration to implications of their operations on employees, customers, competitors, the environment and the community.

But there is a less hostile view which hopes that businesses will voluntarily incorporate broader interests into decision making processes. Perhaps the most well-known political advocate of this form of stakeholder orientation is British Prime Minister Tony Blair, who has argued:

> "We cannot by legislation guarantee that a company will behave in a way conducive to trust and long-term commitment. But it is surely time to assess how we shift the emphasis in corporate ethos, from the company being a mere vehicle for the capital market, to be traded, bought and sold as a commodity, towards a vision of the company as a community or partnership in which each employee has a stake, and where a company's responsibilities are more clearly delineated."[iv]

The resurgence of interest in stakeholder theory and other views that firms should take a broader focus than the interest of shareholders alone has many sources. In its form most hostile to business, it reflects the views of the more radical elements of the anti-globalisation movement, and their related opposition to corporate activities and rights.

While Marxist solutions to the perceived evils of capitalism may have been largely discredited, an underlying hostility to capitalism persists. Its more mainstream political expression lies in the resurgent "'third way" politics of Britain's "New Labour" already discussed, whose electoral successes make it an attractive role model to centre-left parties in Europe and elsewhere, including Australia.

At a fairly diffuse social level, it reflects a response to the changing climate of community opinion which has underpinned that political sea-change, including increased environmental awareness and concern, disquiet at globalisation, hostility to corporations and a view that political processes fail to deliver the social and economic outcomes people want.

Reasons for Adopting a Stakeholder Orientation

Good Behaviour is Profitable

From a business perspective, a persuasive case for adopting a stakeholder orientation is that good corporate citizenship is profitable.

At its most fundamental level, the underpinning mechanism of commerce in free markets is ethical - voluntary cooperation to mutual gain.

A strong case can be argued that this is a more ethical foundation than alternative mechanisms for distributing goods and services which, while perhaps driven by more altruistic motives than self-interest, tend to be achievable only through compulsion and confiscation.

At a more practical level, ethical business is generally profitable business.

Businesses in competitive markets which repeatedly sell over-priced or shoddy goods, which fail to pay suppliers, which exploit or underpay workers or which harm the communities they operate in are usually not profitable for any length of time (although exceptions do exist, at least temporarily).

So good managements and responsible boards have always stressed ethical behaviour on the part of employees and agents, and more general business virtues such as courtesy, honesty, value for money and reliability, knowing these to be a considerable source of long-term competitive advantage.

The report by the NSW State Chamber of Commerce summed up the advantages of corporate social responsibility for the business community generally and for individual enterprises:

> "The business community benefits when companies act responsibly. It gains a voice in the political arena, legitimacy, trust, power and freedom from regulations. These gains ensure that Australian companies will be competitive in domestic and global markets. Enterprise level benefits can be grouped into four areas; operating performance, market goals, human resources and external relations."[v]

The findings of the survey of 115 large public and private Australian entities, conducted by the Centre for Corporate Public Affairs and the Business Council of Australia, confirm this view:

> "For three-quarters of the companies in this study the goal of long-term business sustainability is at the heart of the 'business case' for community involvement. They see involvement not as a means of improving short-term business competitiveness but as a way to maintain trust, support and legitimacy with the community, governments and employees. They see community involvement as a social responsibility of business but one that is clearly aligned with the long-term commercial interest of companies."

Many businesses have embarked tentatively or reluctantly on stakeholder-oriented programs only to embrace them with increasing enthusiasm as they are seen to yield dividends. Companies have implemented triple bottom line accounting and in the process achieved improvements in operating efficiency or savings in input or waste management costs that have greatly exceeded both the cost of the program, and expectations.

But the gains from ethical trading practices and environmental responsibility are not new, so they are not in themselves enough to account for the increase in the number of businesses which publicly and explicitly commit to one or more forms of stakeholder orientation.

The increase in business activity in this area may in part reflect opportunity.

In recent years there has been rapid growth in the range and depth of courses and consultancies, advisory bodies, literature and academics available to assist businesses who wish to adopt a systematic approach to business ethics, corporate social responsibility or triple bottom line accounting, for example.

Yet this increase in the opportunities for devising and implementing stakeholder-oriented policies may itself be an effect of increased demand for these services, rather than the cause for their adoption.

Bad Behaviour is Costly

Rather than corporate virtue being rewarded more richly than in the past, a more plausible explanation for corporations' increased stakeholder orientation may be that its absence is being more heavily penalised. The community is becoming more concerned about the behaviour and ethics of the firms they do business with (and those they don't).

They have more opportunities to monitor, publicise and respond to business behaviour – through the media, the internet, and via pressure groups such as Corpwatch[vi] established specifically in order to monitor and criticise corporate behaviour.

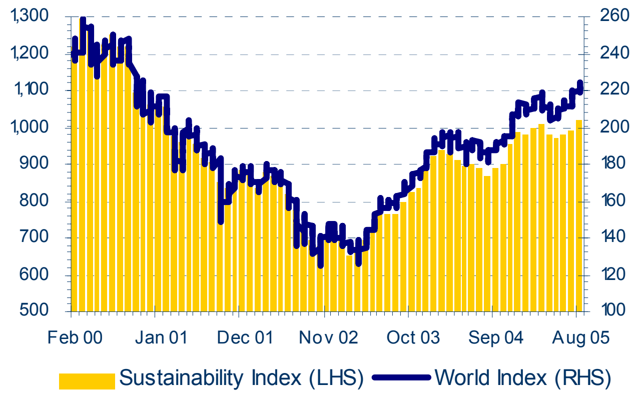
Not only are people more informed about corporate behaviour, they are more willing and able to influence and penalise that behaviour, as consumers, investors, voters and litigants. Public activism has been targeted at corporations in Australia including James Hardy, Alcoa and McDonalds[vii].

The reputations of corporations and their brands have been shown to be vulnerable to concerted publicity campaigns, and businesses have been forced to respond to activists' allegations, even when they were ill-founded[viii].

Ethical investment funds screen out businesses whose products and/or practices they believe immoral, and it has been claimed that investors can make as good or even better returns from investing in these firms than in the general run of corporations[ix], although more recent evidence suggests that the apparently superior performance of sustainable or ethical funds is not necessarily permanent, but depends on market conditions.

Chart 1 illustrates this point. The Dow Jones Sustainability Index[x] matched or outperformed the Dow Jones World Index to early 2000. In recent times however, global markets have strengthened due to the resources boom while the sustainability index, which contains few mining related companies, has flattened.

Chart 1 - Dow Jones Share Prices Indexes
Sustainability Index vs World Index



Source: Yahoo Finance

More hard-nosed corporate investment analysts have also turned their attention to the social, ethical and environmental practices of the businesses they invest in, driven not so much by desire to penalise behaviour deemed immoral, as by concern for the financial risks associated with it. In part this may reflect under-estimation of risk in the past. But it seems to be driven more by the fact that the financial penalties associated with being held guilty of improper behaviour are much greater than ever before, whether guilt is in the eyes of the public, NGOs, or the courts. Boards and directors, as well as shareholders and investment analysts, are reacting to this changed risk environment.

The USA has led the way in the rising tide of litigiousness which has seen huge damages claims awarded against tobacco and gun manufacturers, those who produce faulty goods, polluters and so on. This phenomenon is not limited to the USA but is affecting business behaviour (and also not-for-profit and government agencies) throughout the world.

These phenomena in turn are part of an ongoing process in which the limitations on the liability of businesses and their agents have been steadily unwound, through increases in the penalties applied to corporations and their employees for behaviour perceived to harm individuals or other businesses, and in the range of behaviours which are penalised.

The cost of such penalties affects businesses' bottom lines.

Increasing the range of activities subject to penalty, or the magnitude of penalties imposed, means that a profit-maximising corporation will make increased efforts to ensure that the penalty is avoided – after all, that is the point of raising penalties in the first place.

In summary, a business whose sole purpose is to generate returns for its shareholders has good reason to avoid the costs of acting unethically - whether it is to protect a corporate or brand image, to avoid the damaging effects of consumer boycotts, to attract and retain the investment dollars of shareholders concerned to invest ethically or investment managers concerned at the risks of unethical investment, or to escape the widening net of corporate crimes and liabilities and the increasing penalties they attract.

The financial rewards of virtue and costs of transgression represent a strong business case for behaving ethically.

Trends in CSR

Australia's legislation does not require corporations to specifically take into consideration the interests of stakeholders other than shareholders, nor are companies required to report on the social and environmental dimensions of their activities. However, despite this the evidence is that companies are increasingly taking these factors into consideration in their operations.

The International Survey of Corporate Responsibility Reporting, conducted annually by KPMG, found that 14 out of Australia's top 100 companies prepared corporate responsibility reports in addition to their annual reports in 2002. By 2005, this number had risen to 23 out of Australia's top 100 companies[xi].

The take-up of responsibility reporting among the Australian corporate community has been slower than in other countries. According to the KPMG report, an average of 33 out of the top 100 companies operating in 16 developed countries had prepared stand alone responsibility reports in 2005.

Nonetheless, other surveys have also demonstrated an awareness of social responsibility among Australian businesses.

A survey of 115 large public and private Australian entities, conducted in 2000 by the Centre for Corporate Public Affairs and the Business Council of Australia[xii], found that 85 per cent of participants recognised that their businesses had a social obligation and supported some form of involvement with the community.

In addition, a New South Wales State Chamber of Commerce survey found that 74 per cent of business leaders recognised that their businesses needed to strike a balance between the objectives of building a better society and generating profits. It also found that 78 per cent of Australian companies had a code of ethics or an equivalent statement[xiii].

This evidence suggests that corporate social responsibility matters to Australian businesses. It matters primarily because the shifts in public opinion towards concerns for the social, cultural and environmental consequences of economic activity have occurred at a time when the public have a greater willingness and capacity to monitor business activities than ever before.

Through this, the public has a greater ability to reward and penalise behaviour of which they approve or disapprove, through co-ordinated or individual actions as consumers, investors, voters and litigants.

This is probably the key reason for the increased incidence of explicitly stakeholder-oriented policies in businesses across Australia - they are to a large degree compatible with, and even conducive to, the promotion of shareholder interests. This is discussed in further detail below.

Current Practices

Australian companies are governed by the Corporations Act, the purpose of which is to regulate the formation, operation and closure of corporations and the role of directors and officers. Its purpose is not to set environmental or social standards, nor require a company to behave in a particular way.

Where there is a need to establish minimum standards of behaviour or to prescribe certain types of behaviour, this is appropriately dealt with in specific purpose legislation. In this regard, Australian companies are governed by a large range of legislation, including environmental, financial services, human rights, equal opportunity, sex and racial discrimination, industrial relations, native title, occupational health and safety, taxation and trade practices and fair trading.

In 2002, the Australian Stock Exchange (ASX) Corporate Governance Council developed a set of guidelines, *Principles of Good Corporate Governance and Best Practice Recommendations.* This document articulates 10 core principles that the ASX Corporate Governance Council believes underlie good corporate governance. Attached to these principles are 28 practice recommendations.

Whilst not mandatory, under ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed these best practice recommendations in the reporting period. Where companies have not followed all the recommendations, they must identify the recommendations that have not been followed and give reasons for not following them – the "if not why not" approach. The ASX Best Practice Principles are detailed in Appendix B.

The Australian business community's response to CSR is a compelling example of where, without Government intervention, business has developed sophisticated responses to community issues. Without the need for prescriptive legislation, Australian corporations are already engaged in a wide range of corporate social responsibility activities, developed to suit the particular needs of the corporations and the communities they relate to.

Increasingly, corporations are voluntarily reporting their performances in these areas and subjecting themselves to independent auditing and rating. Some Australian corporations are world leaders in this field. Even where other corporations are not as well advanced in their approaches, there is clear evidence that Australian corporations are progressively increasing the range and sophistication of their corporate social responsibility activities.

One of the primary mechanisms to report on CSR is through the Global Reporting Initiative (GRI). The GRI is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. These Guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services. Further details on the GRI Guidelines are provided in Appendix C.

There are numerous examples of Australian companies that have embraced corporate social responsibility, and provide detailed sustainability reports on the basis of the internationally accepted GRI Guidelines.

Example: BHP Billiton

BHP Billiton espouses an overriding commitment to health, safety, environmental responsibility and sustainable development. This commitment is reinforced by publicly reporting on its sustainability performance (which it has done since 1997) and in 2002 it adopted the GRI Sustainability Reporting Guidelines, and it has been progressively improving its compliance with these guidelines.

As part of its 2005 Sustainability Report, BHP Billiton has included a GRI Navigator, which represents its assessment against each of the GRI Guidelines, and in 2005 took the additional step of reporting on a number of new indicators detailed in the GRI Mining and Metal Supplement, which at this stage has not been finalised.

BHP Billiton requires all operations to produce annual public site sustainability reports. It is the intent of these site-based reports to provide a review of the Health, Safety, Environmental and Community (HSEC) issues and performance specific to their site circumstances, regional context and stakeholder needs.

Its 2005 Sustainability Report was also independently reviewed by an external assessor – URS Australia, which found that "the Report fairly represents the health, safety, environment, community and socio-economic performance of BHP Billiton…and that the Report has been prepared in accordance with the GRI Sustainability Reporting Guidelines 2002"[xiv].

BHP Billiton participates in a number of key external benchmarking initiatives that attempt to measure the Company's sustainable development performance against others in its sector through the Dow Jones Sustainability Index[xv], the FTSE4Good[xvi] and the Storebrand "Best in Class"[xvii].

Issues in Relation to CSR

Conflicting Priorities and Values

Stakeholder entitlement requires operational decision-makers to resolve conflicts between values, objectives and stakeholders' interests. This is difficult because the interests of stakeholders conflict and views on ethical behaviour and social responsibilities differ.

Among a firm's stakeholders, the interests of customers and employees, employees and owners, owners and the community in which the business is operated, the local community and more distant suppliers, are obviously going to conflict on occasion.

More basic questions arise. Who is a stakeholder (virtually anyone, according to Freeman's[xviii] definition)? Are all stakeholders given equal weight, or do some get more consideration than others (e.g. full-time compared to part-time employees)? How are managers to know what all stakeholders' interests are? What if an activity harms some stakeholders and benefits others? What happens when the members of a class of stakeholders have preferences which are not identical (e.g. some employees want weekend work, others don't)?

Most importantly, given the difficulty of knowing what stakeholders' interests are and of eliminating conflicts between them, how is a balance to be achieved?

Commenting on a similar list of conflicts and questions, Elaine Sternberg[xix] argues that:

> "It may now be objected that such problems are, nonetheless, routinely resolved in practice. And indeed they are. But the way that they are managed, is by using the substantive goal of the organisation as a decisive criterion. If the purpose of the corporation is to maximise long-term owner value, or to produce the environmentally-friendliest widgets, or to provide employment for the blind, that purpose enables managers to identify which groups need to be considered, and which of their perceived benefits are relevant and legitimate; it indicates how benefits are to be ranked, and how conflicts are to be resolved. To be workable, stakeholder theory must employ the very substantive objectives that it explicitly rejects."

Not only that, but Sternberg points out that the theory of stakeholder entitlement is not compatible with any organisation (not just a business) having any substantive objective.

Under stakeholder theory, environmental protection, educational excellence, community health, employment of the disabled, care for the aged, equal opportunity or sporting success are no more legitimate as primary aims of an organisation than maximising shareholder value. Each assumes that some stakeholder interests are so important they override others, and in stakeholder theory that assumption is not accepted.

Accountability and Governance

Even if these questions of entitlement can be resolved, harder problems of accountability remain.

Under the shareholder model, the ethical values that underpin the concept of shareholder value maximisation are based on three related principles:

- Respect for individuals' dignity and autonomy, which implies a preference for voluntarism and co-operation over coercion.

- Respect for property rights, which demands that no person should have the right to direct someone else's property to a particular use without their consent (or, fair compensation); and

- Respect for contracts, which should be honoured for ethical as well as legal and practical reasons.

The case for stakeholder orientation beyond that consistent with maximising shareholder value is based on a different set of principles. As described by Elaine Sternberg[xx], the stakeholder entitlement view has as its central tenet:

> "…that organisations, and particularly businesses, must do more than just take their shareholders into account. It maintains that organisations must instead be accountable to all their stakeholders, and that the proper objective of management is to balance their competing interests."

Both the shareholder and stakeholder oriented view of the role of business raise fundamental questions about accountability. However, the latter proves much more difficult for firms to address.

Accountability requires that individuals must account to others for the decisions they make and the way they behave. It also requires defined authority, so that those to whom agents are accountable are entitled to exact penalties on agents who fail to perform.

In a typical shareholder model corporation, directors are accountable to shareholders while employees and other agents are accountable, through managers, to directors.

However, under stakeholder theory Sternberg[xxi] points out that both of these types of accountability are repudiated. In their place, it proposes a structure of accountability which is so diffuse as to be unenforceable.

For example, any bad management decision or employee action can be justified on the grounds that it is in the interest of some stakeholder group.

With employees and managers acting as both agents and stakeholders, the chain of accountability turns into a self-referential loop in which the exercise of authority to the advantage of some stakeholders against others can be legitimised.

To the extent that all stakeholders' interests must be taken into account when significant decisions are made, management is likely to be cumbersome and unresponsive.

For such a model to be effective would demand profound changes in law and corporate governance.

At present, shareholders unhappy with the way a board manages their assets are free to invest elsewhere, or, if a majority of shareholders agree, to dismiss the board. Managements which do not maximise shareholder value are at risk of hostile takeover. Employees who do not carry out the instructions of management can be sacked.

These structures of incentive and accountability are explicitly designed to ensure that management has a strong incentive to put shareholder interests first, within the constraints of the law.

They are based on and reinforced by a structure of corporate governance rules which recognise that managements might not of their own volition always pursue shareholder value as their central priority, and which try to ensure that as near as possible they are made to do so.

This is an environment in which both custom and law aim to ensure a management team which consistently made decisions which are not in the interests of its shareholders does not last.

For as long as shareholders retain the freedom to buy and sell shares and the right to sack directors, those directors are likely to continue to accord special priority to shareholders' wishes.

Whether a legal structure based on accountability to other stakeholders as well as shareholders could be made workable is debatable. What is certain is that such a model would bear little relationship to the system of economic freedom and property rights which underpins our current system.

This does not mean that such stakeholders have no sanctions against the firm; but it means that those sanctions are exercised by means other that its ownership and governance structures. Employees unhappy with a business's employment practices can negotiate changes, resign or take up their grievances through a trades union. Suppliers and customers can stipulate contract conditions, or failing this take their business elsewhere or pursue legal redress when appropriate. Local communities use planning, pollution, trading and other laws and regulations to set limits and conditions on the way businesses operate. Governments apply a plethora of laws to ensure that environmental conditions and social and other protections are enforced by business.

Where the wider aims of corporate social responsibility are pursued by management authority, at the very least the effect is to politicise business. Milton Friedman argues[xxii]:that it is actually more akin to theft than social responsibility:

> '"What does it mean to say that the corporate executive has a 'social responsibility' in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers.
>
> [in pursuing such interests] "…the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money."

Even if such pursuit of social and environmental objectives with other people's resources was legitimate, the manner of that pursuit is unaccountable and undemocratic.

In democracies like Australia, most people are familiar with, and unperturbed by, the processes by which property rights are routinely constrained or removed in the service of the common good, whether through the payment of taxes to support government services and transfers, through laws limiting pollution and noise, zoning restrictions on the use of buildings, and so on.

We might disagree fiercely about how much tax should be raised, from whom, and how the money should be spent. Opinions differ no less on appropriate legislation and regulation, whether the issues are the location of heavy industry, the suburban speed limit or the fencing of swimming pools.

In a democracy, these controversies about how to tax and how much to tax, what to spend and what laws to pass, are subject to public and media scrutiny and community consultation, institutional restraints and the final test of the ballot box.

As Friedman describes it, the use by business leaders of other people's money in pursuit of a broader social objective is analogous to the government's role as taxer, re-distributor and regulator, but without the accountability:

> "We have a system of checks and balances to separate the legislative function of imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law."
>
> "Here, the businessman self-selected or appointed directly or indirectly by stockholders - is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds - all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on."

In effect, the business person becomes a public ("civil") servant, and must be made accountable in a similar manner:

> "On grounds of political principle, it is intolerable that such civil servants - insofar as their actions in the name of social responsibility are real and not just window dressing - should be selected as they are now. If they are to be civil servants, then they must be selected through a political process. If they are to impose taxes and make expenditures to foster 'social' objectives, then political machinery must be set up to guide the assessment of taxes and to determine through a political process the objectives to be served."

Stakeholder orientation beyond that which is consistent with maximising shareholder value opens a whole range of issues of principle concerning property rights and freedom of choice, corporate governance, transparency and political, social and commercial accountability.

The Wider Case Against Regulation

The discussions above present a case against imposing government regulations to compel businesses to consider the interests of stakeholders other than shareholders.

Public and Private Regulation

This does not mean that businesses should be free of environmental, social, safety or other regulation – such rules remain a necessary and important role of government.

Nor does it mean that businesses should or will disregard their impact on the environment and the community. As discussed above, doing business ethically and with regard for the interests of stakeholders is increasingly important to long-term profitability.

Rather, it points out that regulation to achieve ill-specified, ambiguous or conflicting objectives on business is likely to be ineffective or counter-productive.

US Federal Reserve Chairman Alan Greenspan[xxiii] has summed up this policy imperative. Although specifically directed to the regulation of financial instruments, the principles he outlined broadly apply to any form of regulation:

> "In making such evaluations, it is critically important to recognize that no market is ever truly unregulated. The self-interest of market participants generates private market regulation. Thus, the real question is not whether a market should be regulated. Rather, the real question is whether government intervention strengthens or weakens private regulation. If incentives for private market regulation are weak or if market participants lack the capabilities to pursue their interests effectively, then the introduction of government regulation may improve regulation. But if private market regulation is effective, then government regulation is at best unnecessary."

It is naïve and inappropriate to expect businesses to assume social and environmental responsibilities beyond those which comply with the negative imperatives of conventional regulation (don't pollute, pay no less than minimum wages, etc) and maximise shareholder value.

Profiting from Corporate Social Responsibility

Elaine Sternberg and others point out that having regard for the interests and preferences of stakeholders is good business practice and benefits shareholders, stakeholders and the wider community.

There is another sense, however, in which adopting the rhetoric of corporate social responsibility, triple bottom line etc. can be profitable for the wrong reasons – by artificially inflating demand for a business's products under the guise of promoting community wellbeing through mechanisms, which in reality, deliver little or no real community benefit.

For example, Gary Johns, a senior fellow with the Institute of Public Affairs[xxiv], gave a fairly cynical interpretation of the recent involvement of Insurance Australia Group (IAG) in the debate over climate change and the claim that it will increase the risk of damaging climate-related events:

> "…an insurance company cannot change the climate,… but it can change the climate for customers. IAG is using the data to scare people to take out insurance. In other words, it is doing what it normally does, drum up business – but in this instance it is using the cover of the greenhouse issue. IAG is indulging in public policy debate in order to win customers. The Kyoto Protocol is being used as a 'dog whistle' on climate change to have people take-out insurance on weather damage to their properties. Good for business, bad for public policy."

This example highlights a more fundamental argument against corporate social responsibility as a claim to public virtue. Although it can be profitable to be seen as socially and environmentally responsible and costly to be seen as irresponsible, there are dangers in pandering to public opinion when that opinion is not based on facts and good policy. A paper by David Henderson[xxv], a former chief economist at the OECD, highlights this clearly:

> "It may indeed be true, or eventually become true, that a general adoption of CSR [corporate social responsibility] would promote the objective of making MNEs [multi-national enterprises] better liked and appreciated, and thus help to keep them alive and profitable in an unfriendly world. But this would come at the cost of accepting false beliefs, yielding to unjustified attacks, and impairing the functioning of the market economy."

This raises a fundamental problem with the concept of corporate social responsibility: it assumes that triple bottom line accounting, ethical investment, stakeholder entitlement and similar theories will yield better outcomes (for some parties, at least) than an economy in which firms are primarily engaged in maximising long-term value for their shareholders within a framework of laws.

This reflects the widely-held view that good outcomes can only arise from good intentions and that the profit motive is intrinsically distasteful.

Above all, it is indicative of a lack of faith in the capacity of the 'invisible hand' of the free market to deliver a better economic, environmental and social outcome than the good intentions of business leaders, suitably stiffened by laws, incentives and stakeholder responsibilities.

Proponents of this view point to the failure of free markets to deliver social, economic and environmental outcomes as good as we might wish, and conclude that the economic system is a failure. But those who doubt the efficacy of markets have never yet been able to point to an economy or society where a 'visible hand' has done better, whether that hand is guided by the state, a plurality of stakeholders, or well-intentioned business leaders.

The real virtue of the good corporate citizen is that it generates returns for investors by providing customers with the goods and services they want, at prices they are prepared to pay, while proving trustworthy and responsive enough to earn repeat business.

In the process, it creates jobs, bids up wages, pays taxes, and innovates in the perpetual search for an advantage over its competitors. All of this contributes far more to society than pious good intentions.

In all of this, government has a proper role in shaping the regulatory environment where good business practice alone might not result in efficient outcomes. This is achieved in Australia through provisions in corporations and trade practices law, health and safety standards, environmental protection regulations, anti-discrimination and labour protection laws, and competition and consumer protection initiatives.

But by increasing business costs, blurring accountability and impeding the efficient operation of capital markets, the advocates of mandated corporate social responsibility and stakeholder entitlements would impede the business sector's capacity to make this valuable contribution to the economy and society.

David Henderson's paper concludes with a warning of the potential damage which corporate social responsibility and related movements could inflict. Though lengthy, it is worth quoting in full:

> "CSR is often presented, by moderates and enthusiasts alike, as a sober and judicious response to challenges that have to be met and new developments on the world scene. Such a description does not fit the facts. Many of the alleged new developments have not in fact taken place: they are part of the mythology of global Salvationism. Because the myths are largely believed, because the rationale and functioning of a market economy are not well understood, and because of widespread acceptance of the need for deliverance from above, the assessment of issues and events by many international businesses, and by others in the business milieu, appears as neither judicious nor informed. Appeasement, and the wish to disarm opposition, go together with a large measure of sympathy with, and acceptance of, a collectivist perspective. The views and demands of NGOs and other hostile critics are treated as more soundly based and more representative than they really are. A misleading view of the world is uncritically accepted.
>
> "CSR is flawed in its prescription as well as its diagnosis. What it proposes for individual businesses, through 'stakeholder engagement' and giving effect to the 'triple bottom line', would bring far-reaching changes in corporate philosophy and practice, for purposes that are open to question and with worrying implications for the efficient conduct of enterprises. Across economic systems and political boundaries, it would strengthen existing tendencies to regulate transactions, and to limit competition, in ways that would further restrict the opportunities and freedom of choice of people and enterprises. These various effects, both within firms and beyond them, would undermine the market economy and reduce welfare. Despite the attractions of the phrase and the hopes that it appears to offer, the adoption of CSR marks an aberration on the part of the many businesses concerned, and its growing hold on opinion generally is a matter for concern."

Alternative Measures to Regulation

Voluntary mechanisms can encourage operational decision makers to have regard for stakeholder interests without the need for prescriptive forms of regulation. This is because commercial self-interest is a powerful motivation for firms to behave ethically.

Voluntary measures that go beyond shareholder maximisation are likely to be limited in their application. The NSW State Chamber of Commerce paper on corporate social responsibility encapsulates the difficulty that operational decision makers' face in embracing stakeholder interests outside of those that increase shareholder value:

> "Most Australian business leaders would like their company to have a positive impact on society and the environment. Yet in the day-to-day commercial pressures to maximise shareholder value and profitability, managers are wondering if they can afford to have 'fuzzy feelings' about their business operations."

Irrespective of voluntary measures and/or regulation, reporting is often seen as a means by which stakeholders can keep corporations accountable for their social and environmental performance (the triple bottom line) in the same vein that financial reporting keeps boards of directors and chief executives accountable to owners.

However, it is not logical that a company's social and environmental practices be separately disclosed to maintain accountability in the same way that financial information is disclosed.

It is considerably easier to compare financial performance across firms than it is to compare social and environmental performance. Are users, whether stakeholders or ethical investment funds, expected to judge whether one entity's involvement with indigenous communities is better than donations made by another entity to a children's charity? Information about a corporation's social and environmental activities is not material like financial information. Shareholders and stakeholders do not derive benefit from knowing what practices are employed but from the effects of such practices.

Appendix A: Terms of Reference

In March 2005, the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP, wrote to the Convenor of the Advisory Committee in the following terms.

> I am writing to refer an issue to the Corporations and Markets Advisory Committee (CAMAC) for consideration and advice.
>
> The issue concerns the extent to which the duties of directors under the *Corporations Act 2001* (the Corporations Act) should include corporate social responsibilities or explicit obligations to take account of the interests of certain classes of stakeholders other than shareholders.
>
> Under both the Corporations Act and the common law, directors have a duty to act in the best interests of the corporation. In this regard, they are required to consider the interests of shareholders and, in some limited circumstances, creditors. This position reflects the long-standing view of the corporate officer as an agent of shareholders.
>
> Legislation other than the Corporations Act imposes additional obligations on companies and their directors in relation to employees and the environment. For example, companies must pay their employees at least minimum rates of pay and they must comply with occupational health and safety, anti-discrimination and equal opportunity requirements. Companies must also comply with a wide range of environmental requirements.
>
> In modern society, a great deal of business and other activities are conducted by corporate entities. Given the broad economic, social and environmental impact of these activities, there is an understandable interest in the legal framework in which corporations make decisions. A question that has been raised from time to time is whether the current legal framework allows corporate decision makers to take appropriate account of the interests of persons other than shareholders.
>
> Apart from the question of clarifying the legal position of directors, there may be a positive role for Government to play in promoting socially responsible behaviour by companies through various initiatives such as voluntary codes of practice.
>
> A related issue is whether to introduce mandatory requirements for larger companies to include with their annual reports, a report on the social and environmental impact of the company's activities. This could either be in the form of a narrative or quantified report. Mandatory reporting of such information could allow interested investors to take account of these matters in making investment decisions.
>
> Having regard to the matters discussed above, I request that CAMAC consider and report on the following matters:

1. Should the Corporations Act be revised 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?

2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Appendix B – ASX Best Practice Principles

The ASX Corporate Governance Council developed a set of guidelines, *Principles of Good Corporate Governance and Best Practice Recommendations.* This document articulates 10 core principles that the ASX Corporate Governance Council believes underlie good corporate governance. A company should:

1. Lay solid foundations for management and oversight – Recognise and publish the respective roles and responsibilities of board and management.

2. Structure the board to add value – Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

3. Promote ethical and responsible decision-making – Actively promote ethical and responsible decision-making.

4. Safeguard integrity in financial reporting – Have a structure to independently verify and safeguard the integrity of the company's financial reporting.

5. Make timely and balanced disclosure – Promote timely and balanced disclosure of all material matters concerning the company.

6. Respect the rights of shareholders – Respect the rights of shareholders and facilitate the effective exercise of those rights.

7. Recognise and manage risk – Establish a sound system of risk oversight and management and internal control.

8. Encourage enhanced performance – Fairly review and actively encourage enhanced board and management effectiveness.

9. Remunerate fairly and responsibly – Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

10. Recognise the legitimate interests of stakeholders – Recognise legal and other obligations to all legitimate stakeholders.

Appendix C – GRI Guidelines

The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines (GRI, 2002). These Guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services.

It seeks to elevate sustainability reporting to the same level of rigour, comparability, credibility, and verifiability expected of financial reporting, while serving the information needs of a broad array of stakeholders from civil society, government, labour, and the private business community itself.

The GRI *Guidelines* identify the information for inclusion in a GRI-based report, and are designed to be flexible, with a range of options suitable for reporting organisations at any level of experience and sophistication. The GRI recognises the need for many organisations to build their reporting capacity in an incremental fashion, moving gradually toward greater coverage, transparency, and structure in terms of continuity and consistency from year to year. Organisations that choose this incremental approach may informally use the *Guidelines*, and select certain principles, elements, and indicators to begin their reporting programmes. Getting started is the critical first step.

Other organisations, aspiring to leadership roles in the sustainability arena, may wish to identify their reports as prepared "in accordance" with the 2002 GRI *Guidelines*. To use this term, reporters must meet certain minimum requirements specified in the *Guidelines.*

"In Accordance" Requirements

1. Report on the organisational profile, governance and management systems.

2. Include a GRI Content Index, linking GRI components to information actually contained in the report.

3. Respond to each core indicator by either (a) reporting on it, or (b) explaining its omission.

4. Ensure that the report is consistent with GRI's reporting principles.

5. Include a statement signed by the board or CEO indicating that the report was prepared in accordance with the 2002 GRI *Guidelines* and represents a balanced and reasonable presentation of the organisation's sustainability performance.

The GRI reporting principles are the underpinnings of report content. They are the foundation of credible reporting, equal in importance to the content itself. The reporting principles are:

- ***Transparency:*** Full disclosure of the processes, procedures and assumptions in report preparation are essential to its credibility.

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- ***Inclusiveness:*** The reporting organisation should engage its stakeholders in preparing and enhancing the quality of reports.

- ***Auditability:*** Reported information should be recorded, compiled, analysed and disclosed in a way that enables internal auditors or external assurance providers to attest to its reliability.

- ***Completeness:*** All material information should appear in the report.

- ***Relevance:*** Reporting organisations should use the degree of importance that report users assign to particular information in determining report content.

- ***Sustainability Context:*** Reporting organisations should seek to place their performance in the broader context of ecological, social or other issues where such context adds significant meaning to the reported information.

- ***Accuracy:*** Reports should achieve a degree of exactness and low margin of error to enable users to make decisions with a high degree of confidence.

- ***Neutrality:*** Reports should avoid bias in selection and presentation of information and provide a balanced account of performance.

- ***Comparability:*** Reports should be framed so as to facilitate comparison to earlier reports as well as to reports of comparable organisations.

- ***Clarity:*** Information should be presented in a manner that is understandable by a maximum number of users while still maintaining a suitable level of detail.

- ***Timeliness:*** Reports should provide information on a regular schedule that meets user needs and comports with the nature of the information itself.

Report Content

The *Guidelines* recommends that five sections appear in a sustainability report:

1. ***Vision and Strategy:*** A statement from the CEO and discussion of the reporting organisation's sustainability strategy.

2. ***Profile:*** An overview of the reporter's organisation, operations, stakeholders, and the scope of the report.

3. ***Governance Structure and Management Systems:*** A description of the reporter's organisational structure, policies, management systems, and stakeholder engagement efforts.

4. ***GRI Content Index:*** A cross-referenced table that identifies the location of specified information to allow users to clearly understand the degree to which the reporting organisation has covered the content in the GRI *Guidelines*.

5. ***Performance Indicators:*** Measures of performance of the reporting organisation divided into economic, environmental, and social performance indicators. Organisations may adopt this format or modify it to enhance usefulness of the report to its stakeholders.

Environmental and Social Performance Indicators

Environmental indicators concern an organisation's impacts on living and non-living natural systems, including eco-systems, land, air and water. Included within environmental indicators are the environmental impacts of products and services; energy, material and water use; greenhouse gas and other emissions; effluents and waste generation; impacts on biodiversity; use of hazardous materials; recycling, pollution, waste reduction and other environmental programmes; environmental expenditures; and fines and penalties for non-compliance.

- The GRI list 16 Core Indicators for Environmental Performance. There are also a number of environmental indicators specific to the mining and metals sector, as detailed in the GRI Mining and Metals Supplement Pilot Version 1.0.

Social indicators concern an organisation's impacts on the social systems within which it operates. GRI social indicators are grouped into three clusters: labour practices (e.g. diversity, employee health and safety), human rights (e.g. child labour, compliance issues), and broader social issues affecting consumers, communities, and other stakeholders (e.g. bribery and corruption, community relations).

- The GRI list 11 Core Indicators for Labour Practices and Decent Work, seven Core Indicators for Human Rights, three Core Indicators for Society and three Core Indicators for Product Responsibility. There are also a number of social indicators specific to the mining and metals sector, as detailed in the GRI Mining and Metals Supplement Pilot Version 1.0.

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Friedman, Milton. *The Social Responsibility Of Business Is To Increase Its Profits*, article in originally printed in the New York Times (1970), accessed from http://homepages.bw.edu/~dkrueger/BUS329/readings/friedman.html

Sternberg, Elaine '*The Stakeholder Concept: A Mistaken Doctrine*', Foundation for Business Responsibilities, Issue Paper No. 4, November 1999. Sternberg differentiates between two essentially

Comments and Notes

[i] Friedman, Milton (1962), "Capitalism and Freedom", University of Chicago Press.

[ii] Lord Chancellor of England Edward First Baron Thurlow, cited in Business & Society Review, No. 72, Winter 1990, p. 51

[iii] Sternberg, Elaine 'The Stakeholder Concept: A Mistaken Doctrine', Foundation for Business Responsibilities, Issue Paper No. 4, November 1999.

[iv] Quotation taken from Peters, P. "Tony Blair's "Stakeholder Economy": A Midterm Assessment", October 1999, on the Lexington Institute's web site. Original source.

[v] "Taking The First Steps: An Overview Of Corporate Social Responsibility In Australia" NSW State Chamber of Commerce, February 2001, page 6. First paper in a series entitled "the common good".

[vi] See http://www.corpwatch.org.

[vii] In 2004, industrial firm James Hardy was the subject of boycotts and public scrutiny after it stalled on payouts to cancer victims whose illnesses were brought on through the use of James Hardy products containing asbestos.
In 2002, Alcoa came under intense public scrutiny in WA after it was forced to shut down a piece of refinery equipment blamed for causing serious health effects. Alcoa resolved several multi-million dollar compensation claims from its workforce and it bought up several houses from nearby residents.
In 2005, Tasmanian potato farmers launched a nationwide campaign demanding that McDonald's demonstrate more social responsibility. Tasmanian food processor Simplot lost half its McDonald's french fries contract to New Zealand, creating a loss of about $50 million to the Tasmanian economy.

[viii] For example, the cases of Brent Spa and McDonalds. In the Brent Spa case, Greenpeace ran a campaign which included a range of assertions subsequently shown to be false, but which nonetheless led Shell Expro to abandon plans to sink its Brent Spar installation in the North Sea.
In the case of McDonalds, the 2004 documentary 'Super Size Me' by Morgan Spurlock led to the fast food outlet phasing out its trademark 'super size' fries and drinks in its U.S. restaurants even though, as McDonalds pointed out, Spurlock's decision to eat nothing but McDonalds food for a month was irresponsible.

[ix] In an article on the financial and market information website TheMotleyFool, Chris Rugaber concludes that socially responsible investment funds do not necessarily yield lower rates of return, but that differences in performance may be short-term effects of differences in portfolio composition. Fees and expenses tend to be higher than for other comparable investment funds. See Rugaber, "socially responsible investing" 28 March 2001, on http://www.fool.com/Specials/2001/sp010329.htm.

[x] The Dow Jones Sustainability Indexes were launched in 1999 and are the first global indexes to track the financial performance of the leading sustainability-driven companies worldwide. Selection in based on an independent benchmark based on economic, environmental and social criteria. See http://www.sustainability-index.com.

[xi] KPMG Sustainability Services, *International Survey of Corporate Responsibility Reporting 2005*. Page 10.

[xii] Centre for Corporate Public Affairs in conjunction with Business Council of Australia, *Corporate Community Involvement: Establishing a Business Case*. Page 11.

[xiii] "Taking The First Steps: An Overview Of Corporate Social Responsibility In Australia" NSW State Chamber of Commerce, February 2001, page 11. First paper in a series entitled "the common good".

[xiv] URS Australia, 2005, *Assurance Statement*, Melbourne.

[xv] The index consists of more than 300 companies that represent the top 10 per cent of leading sustainability companies in 59 industry groups in 34 countries. The index selects the top 10 per cent of companies in the global metals and mining sector, based on over 90 different performance indicators.

[xvi] This index is designed to measure the performance of companies that meet globally recognised corporate responsibility standards and to facilitate investment in those companies.

[xvii] One of the leading proponents of socially responsible investing, Storebrand in Norway, researched the mining industry and ranked BHP Billiton 'best in class' for its environmental and social performance out of 21 metals and mining companies covered. Storebrand's analysis is based on a best-in-class approach. Only sector leaders— companies ranking in the top 30th-percentile in both environmental and social dimensions— qualify for investment in socially responsible portfolios managed by Storebrand. In this way, the analysis identifies those companies which are moving their industry toward sustainable solutions.

[xviii] Evan, W and Freeman, R (1993) 'A Stakeholder Theory of the Modem Corporation: Kantian Capitalism,' in Beauchamp and Bowie, Ethical Theory and Business, p. 82.

[xix] Sternberg, Elaine 'The Stakeholder Concept: A Mistaken Doctrine', Foundation for Business Responsibilities, Issue Paper No. 4, November 1999.

[xx] Sternberg, Elaine 'The Stakeholder Concept: A Mistaken Doctrine', Foundation for Business Responsibilities, Issue Paper No. 4, November 1999. Sternberg differentiates between two essentially benign ideas about stakeholders and a third strand she calls stakeholder entitlement theory: "Two of usages of 'stakeholding' are commonplace and unobjectionable. The first is a conventional observation about motivation: people are more likely to take an interest in a process when they consider that they have a stake in its outcome; the stake need not be financial. The second innocuous usage is simply a reminder that the world is complex: many factors must ordinarily be considered when pursuing even ostensibly simple outcomes. This is a basic truth that successful businesses have long understood and respected"

[xxi] 'Creating and Maintaining an Ethical Corporate Climate', Woodstock Theological Center Seminar in Business Ethics, Georgetown University Press, 1990.

[xxii] Friedman, Milton. 'The Social Responsibility Of Business Is To Increase Its Profits', article in originally printed in the New York Times (1970), accessed from http://homepages.bw.edu/~dkrueger/BUS329/readings/friedman.html

[xxiii] Remarks by Federal Reserve Chairman, Alan Greenspan. "*Government Regulation and Derivative Contracts*", at the Financial Markets Conference of the Federal Reserve Bank of Atlanta, Coral Gables, Florida. February 21, 1997.

[xxiv] *"Insurance Company Whips Up a Storm"*, by Gary Johns. The Australian Financial Review – Opinion. 16 August, 2005.

[xxv] Henderson, David. 'Misguided Virtue: False Notions Of Corporate Social Responsibility', New Zealand Business Roundtable, June 2001. p.86

CAMAC Discussion Paper: Corporate Social Responsibility

8 March 2006

Australian Bankers' Association Inc. ARBN 117 262 978
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Table of Contents

1. Executive summary -------- 1

2. Background: corporate social responsibility -------- 2

2.1 What is corporate responsibility? 2

2.2 What is an appropriate approach to responsible corporate behaviour? 3

2.3 What are the incentives or disincentives for a company to conduct its business in a socially responsible manner? 3

2.4 What is triple bottom line reporting? Could triple bottom line reporting be improved? 4

3. Australia's banks and corporate responsibility: current practice -------- 6

3.1 Do corporate decision makers have regard for the interests of stakeholders, and should they have regard for the interests of stakeholders? 6

3.2 Examples of corporate responsibility in Australia's banking industry 8

4. Directors' duties: current position -------- 11

4.1 Does the current legal framework constrain directors from taking into account the interests of particular groups or broader community considerations when making corporate decisions? 11

5. Corporate reporting: current practice -------- 15

5.1 Corporate reporting requirements in Australia 16

5.2 Bank-specific conduct and disclosure obligations 18

5.3 Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities? Should there be any changes to the ASX Listing Rules to require disclosure of non-financial information to the market? 20

6. Responsible business practices: partnership approach -------- 21

6.1 Should Australian companies be encouraged to adopt socially and environmentally responsible business practices? 21

6.1.1 Business initiatives 21

6.1.2 Government initiatives 22

6.1.3 Education initiatives 23

7. Conclusion -------- 23

CAMAC Discussion Paper: Corporate Social Responsibility

1. Executive summary

Corporate responsibility is increasingly being placed on the public agenda as being a necessary part of good business management practice that should be a driving factor of corporate strategy. Concurrently, an increasing number of companies are recognising that corporate responsibility is an important part of their brand or reputation management and corporate identity.

The banking industry in Australia is recognised for its leadership in the area of corporate responsibility. Many banks acknowledge corporate responsibility and have adopted programs and practices that demonstrate their commitment to social and environmental performance, as well as financial performance. Banks that have adopted corporate responsibility have recognised it as a driving factor for being able to distinguish themselves through effective forms of stakeholder engagement.

The high level of innovation, creativity and competition regarding corporate responsibility is reflected in many banks introducing internal programs and undertaking extensive external programs and some banks producing an annual 'CSR-type report', along with their annual report and financial statements. This voluntary commitment by Australia's banks reflects the growing importance of responding to the expectations of shareholders, customers and the community.

In relation to this inquiry, the ABA makes the following points:

1. The ABA believes that corporate decision makers already have the ability within the current legislative framework to have regard for the interests of shareholders and other stakeholders by exploiting corporate opportunities that are in the long-term interests of the company.

2. The ABA believes that directors should have regard for the short-term and long-term interests of the company to ensure sustainable economic growth and increased profitability for the company. However, corporate decision making should involve determining relevant interests, based on the nature of the business activities, the different business models and industry sectors, and the different operational issues impacting their stakeholders. Companies should be responsible for their decisions as they impact on stakeholders, as these decisions will inevitably impact overall financial and operational performance.

3. The ABA does not support revising the Corporations Act to oblige or explicitly allow directors to take into account the interests of other stakeholders. A legislative amendment that requires directors to take account of other stakeholders as part of their statutory duty to the company could confuse the role of directors. The ABA considers that the current legislative framework already permits corporate decision makers to have regard for stakeholders in addition to shareholders. Furthermore, a statutory obligation could have adverse consequences for innovation in corporate responsibility practices, and therefore is impractical, unnecessary and potentially counterproductive.

4. The ABA does not support codification of sustainability reporting requirements or a legislative amendment that prescribes a reporting framework. A prescribed reporting framework could limit the value of such disclosure as well as limit the company's ability to determine what best suits its reporting needs and the needs of its shareholders and stakeholders.

Mandating corporate responsibility will not necessarily result in better outcomes, as prescribing requirements in addition to the existing framework is likely to result in a 'tick the box' approach, which is not desirable and defeats the spirit and intent behind the concept of corporate responsibility.

2. Background: corporate social responsibility

2.1 What is corporate responsibility?

> *Corporate social responsibility is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis*[1]*.*

There are many definitions of corporate responsibility, but the concept as expressed by the European Commission is widely recognised. Corporate responsibility means not just fulfilling legal obligations, but voluntarily adopting business practices that go beyond legal and regulatory compliance by integrating business activities with a balanced response regarding wider considerations for the environment, human and social capital.

The ABA supports the proposition that "the focus [of corporate responsibility] is on the way in which the affairs of companies are conducted, and the ends to which their activities should be directed, with particular reference to the environmental and social impact of corporate conduct[2]."

Globalisation has created opportunities for companies, but has also placed increasing demands on business reputation and company brand, which play an important role in a competitive corporate environment. Consequently, shareholders and other stakeholders are seeking greater disclosure of information, financial reporting and management accountability; and companies are seeking greater knowledge, competencies, performance and competitive advantage.

Essentially, the concept of corporate responsibility involves:

- Corporate behaviour voluntarily adopted that goes beyond legal obligations because the decision makers have deemed that responsible business practices and behaviours can lead to improved long-term performance;

- Corporate practices intrinsically connected to sustainable development because businesses integrate financial, social and environmental considerations into their day-to-day activities; and

- Corporate culture incorporated into core business strategies because responsible management of financial and non-financial risks is in the long-term interests of the company as well as other stakeholders.

Companies that take into account stakeholder expectations and broader community attitudes in their forward looking strategies can be better placed to address business risks and take advantage of business opportunities that may arise.

[1] Some commentators refer to the concept of "corporate social responsibility". The ABA considers that arguably corporate social responsibility and corporate responsibility are interchangeable terms. Definition of corporate responsibility is contained in *Green Paper. Promoting a European framework for Corporate Social Responsibility.* Commission of European Communities. Brussels. (p6) http://europa.eu.int/eur-lex/en/com/gpr/2001/com2001_0366en01.pdf

[2] CAMAC (2005). *Discussion Paper: Corporate Social Responsibility*. November 2005. (p3).

2.2 What is an appropriate approach to responsible corporate behaviour?

A *compliance approach* to corporate responsibility emphasises that companies are obliged to comply with the letter of the law, regardless of the commercial consequences. Indeed, there exists a number of Commonwealth, State and Territory statutes regarding occupational health and safety, anti-discrimination, industrial relations, equal opportunity, consumer protection and environmental impact as well as international covenants that stipulate minimum standards of corporate behaviour. However, the ABA believes that a corporate responsibility approach that merely reflects compliance does not necessarily ensure responsible business practices, an ethical corporate culture or long-term sustainable performance.

A *philanthropic approach* to corporate responsibility involves companies giving to the community in a variety of financial and non-financial ways, such as community donations, corporate sponsorship, business support for community projects, partnerships with community or welfare groups, staff volunteering for community projects, etc. Provided there is some direct or indirect benefit for the company, a philanthropic approach to corporate responsibility can both enhance a company's long-term economic interests and deliver value to the community. The ABA considers that this approach is a sub-set of a more holistic corporate responsibility approach.

A *commercial approach* to corporate responsibility emphasises that it is likely to be in the short-term and long-term interests of a company to take into account the environmental and social context in which the business operates. Australia's banks recognise that corporate responsibility is not merely in the domain of philanthropic activities, but is a concept that broadly covers a wide range of corporate-community-employee activities that deliver value to the community as well as returning value to the company and its shareholders.

The ABA believes that the value of corporate responsibility is in the voluntary adoption of innovative business practices that reflect flexible and strategic business judgements by the Board in terms of financial considerations (such as allocating capital and other resources) and social and environmental considerations. It is important for the Board to retain discretion in assessing the interests of stakeholders to determine when, and to what extent, certain stakeholders in particular circumstances may be impacted by the decisions of the company.

2.3 What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

Many companies have suffered significant losses in market value because they did not anticipate or manage business risks. Comprehensive management of risks allows companies to improve their knowledge about the environment in which they operate and to be better placed to prevent, minimise or recover from losses in shareholder value.

Some of the drivers of corporate responsibility for Australia's banks include:

- *Enhanced governance to respond to business risks*: profiling and managing risks and being able to anticipate and respond to emerging issues to improve operational performance;

- *Improved ability to understand business performance*: benchmarking market position and competitiveness against own targets and competitors to provide value to customers;

- *Improved ability to attract and retain quality employees*: enhancing employee recruitment, retention and motivation;

- *Improved ability to conduct a dialogue with stakeholders*: delivering innovative communications and managing investor and public relations;

- *Better financial monitoring of resource allocation*: categorising use of resources more systematically to identify new business opportunities;
- *Greater profile for raising capital*: disclosing financial and non-financial information to shareholders can reduce market volatility in share price and translate into greater investor confidence and improved opportunities for managing capital; and
- *Enhanced market reputation*: integrating transparent and accountable business practices can build long-term value and translate into competitive advantage and better brand and reputation management.

It is in the interests of banks to enhance internal and external governance. A systemic failure to respond to community expectations could translate into increased legal and regulatory obligations, increased operational and compliance costs, reduced employee support and reduced reputation and brand image.

Corporate responsibility can provide a way for companies to manage their reputation with the market by considering their operational activities and how to best represent their corporate culture. Part of enhancing responsible business practices and promoting disclosure of financial and operating performance is to consider how best to communicate the prospects of the company; not just how the company has performed, but how it expects to perform over the long-term.

2.4 What is triple bottom line reporting? Could triple bottom line reporting be improved?

Triple bottom line reporting essentially captures a broader range of measures of organisational success – economic, environmental and social. Triple bottom line reporting tends to be a qualitative summary of performance including non-financial indicators and metrics, but is increasingly becoming more quantitative. In considering current performance some banks currently provide an assessment of future trends, prospects and sustainability for the company. Triple bottom line and sustainability reporting is often an opportunity for companies to disclose to shareholders and other stakeholders information they already report under various Federal and State laws or industry standards.

There are a number of triple bottom line or sustainability reporting frameworks; whether that is a social impact report, stakeholder impact report, environmental impact report, community engagement report, CSR report, sustainability report, etc. The *Global Reporting Initiative (GRI) Sustainability Reporting Guidelines* is a set of reporting principles that contain specific content indicators that guide a company's thinking about their social and environmental performance and assist in the preparation of a sustainability report.

The GRI guidelines are becoming the most commonly adopted set of guidelines for reporting on corporate sustainability and are widely recognised. A number of ABA member banks use the GRI guidelines as part of their annual performance reporting. The GRI guidelines provide finance sector specific guidelines and also allow companies to select indicators in a systematic manner. The ABA notes that the third generation of the GRI guidelines are currently available for public comment in draft form and are due to be finalised later this year.[3]

[3] http://www.grig3.org/

However, due to the early stage of development of triple bottom line reporting, there are still some issues to be resolved with reporting indicators, including:

- Lack of standardised or imprecise performance criteria or reporting indicators;
- Lack of guidance on reporting intangibles; and
- Lack of comparability of company performance.

A significant challenge for triple bottom line reporting is ensuring that reporting is relevant to the company, its shareholders and its other stakeholders. The GRI guidelines are a substantial reporting framework that contains many performance criteria and reporting indicators; not all these criteria or indicators are going to be relevant to all businesses. It is important that any reporting framework enhances disclosure and transparency to the market, and does not generate 'information overload'. It is also important that any reporting framework evolves and reflects not just the disclosure needs of both the business and the community but also the changing nature of commercial operations.

In addition to some impediments with availability and applicability of reporting indicators, some other impediments with triple bottom line reporting include costs and resource constraints. This highlights the importance of ensuring a flexible reporting framework where reporting indicators are not restricted or mandated. It is important for companies to be able to select reporting indicators that reflect the realities of their business as well as the expectations of their shareholders, stakeholders and the wider community.

The ABA considers that part of aligning triple bottom line reporting to business and community expectations is ensuring that the report is internally verified. The larger ABA members also consider that external verification is an important part of building trust with stakeholders and integrity of reporting. However, external verification can generate costs that inhibit smaller companies from undertaking extensive triple bottom line reporting, and therefore should be tailored to the size and nature of the business. The ABA suggests that disclosure of whether the report has been externally verified can be taken into account by stakeholders in the weight they give to the report.

In addition to the GRI guidelines, various business groups in Australia have released a number of publications about how corporate Australia may introduce triple bottom line reporting[4]. In addition to guidance issued by business groups, CPA Australia and the University of Sydney have been provided with a $1 million grant from the Government to develop a framework for corporate reporting of non-financial information[5]. The Australian Accounting Standards Board (AASB) has also announced it is looking at developing a standard for triple bottom line accounting[6].

[4] The G100 released Sustainability: A Guide to Triple Bottom Line Reporting in June 2003, highlighting the importance of aligning triple bottom line reporting with the business strategy. The Business Council of Australia (BCA) has released a number of documents on sustainable development and triple bottom line reporting, including Towards Sustainable Development: How leading Australian and global corporations are contributing to sustainable development (May 2001). The Institute of Chartered Accounts Australia (ICAA) has released its report Environmental Management Accounting (EMA) containing case studies conducted in conjunction with Environment Australia and EPA Victoria. The ICAA also has produced a number of articles and a regular Triple Bottom Line newsletter. CPA Australia has published a number of research reports, including Triple Bottom Line: A Study of Assurance Statements Worldwide and Sustainability Reporting Practices, Performance and Potential. CPA Australia is currently conducting a sustainability and triple bottom line project to examine 'responsible investment' portfolio performance, security market disclosure responses and corporate governance performance relationships.

[5] Buffini, F (2005). *Reporting framework*. Australian Financial Review. 06 July 2005.

[6] Gettler, L (2005). *Making coming clean a standard practice*. The Age. 28 July 2005.

3. Australia's banks and corporate responsibility: current practice

Increasingly, companies are coming to the conclusion that businesses that take a broader view of managing business risks can shape a healthier, more productive corporate culture and thereby a sustainable and profitable company. However, as already stated, how companies, including banks, will adopt corporate responsibility will, and should, depend largely on their business model, their customers and other stakeholders. Similarly, what performance criteria or reporting indicators are of most relevance will, and should, depend on the operations of the company. Integrated corporate responsibility can be a mechanism for management to better understand the relationship between the company and its shareholders and other stakeholders.

3.1 Do corporate decision makers have regard for the interests of stakeholders, and should they have regard for the interests of stakeholders?

In practice, responsible management of a company involves balancing short-term and long-term performance with regard to those factors that determine the sustainability of the company; such as consideration of the interests of shareholders and other stakeholders who can have a significant impact on the successful operations of the company. Australia's banks recognise the importance of shareholders, other stakeholders and the wider community in all aspects of the financial services business. Essential to the operation of the banking business are employees, depositors, investors and consumers of financial products as well as government and regulators that set the legal and regulatory regime for banks.

Banking businesses would not exist without customers purchasing financial products or using financial services, and therefore customer expectations can have a significant impact on the financial and reputational performance of a bank. Emerging business models and distribution across various types of financial products and services within the financial services industry means that without suppliers and distributors the business would also not exist. Competition within the financial services industry for highly skilled professionals means that successful banks provide optimal conditions for their employees. Increasing legal and regulatory obligations placed upon the financial services industry means that relationships with Government are important. However, few companies could disregard the interests of these internal and external stakeholders for very long and continue to be a viable and profitable business.

The banking industry is strongly committed to stakeholder engagement as a part of corporate behaviour. Some examples of how banks engage with stakeholders as part of day-to-day business practice includes, but is not limited to, customer research to understand customer needs and employee consultations and stakeholder forums to manage feedback and expectations. The following provides a brief overview of some of these programs and activities.

Employees: Banks adopt people management principles that include career opportunities and performance evaluation; assessment of employment policies; labour laws (including equal opportunity and workplace diversity, occupation health and safety); training, learning and development; grievance processes; work-life balance and flexible working arrangements; competitive remuneration; protecting employee entitlements; work conditions that respect human rights and freedom of association.

Customers: Banks adopt customer service principles that include respecting customer privacy; product development and service delivery; equity and access to banking products and services (including adoption of Disability Action Plans, financial inclusion responses, etc); transparency of business; responsible marketing practices; customer advocacy, complaints and dispute resolution; and socially responsible investing.

Suppliers: Banks adopt supplier management principles that include supply chain management; sustainability performance; and human rights practices of third parties.

Environment: Banks adopt environmental management principles that include meeting or exceeding environmental standards; resource usage; environmental risk factored into lending practices; reporting on climate change, water and energy management; trading and market environmental solutions; and awareness raising campaigns.

Community: Banks adopt community service principles that enhance social contribution such as financial literacy; strategic partnerships (including with the community and welfare groups, not-for-profit and non-government organisations); community advisory panels; and philanthropic activities (including vocational training, support for socially and financially excluded people, sponsoring sport and cultural events, charitable donations).

* The ABA notes that this overview is an amalgamation of general stakeholder engagement programs and corporate responsibility activities and is indicative of practices across the banking industry; however, it may not reflect an individual bank's particular corporate responsibility practices.

In addition to these programs and activities, some banks are preparing specialised reports that align financial reporting with sustainability reporting to provide a more holistic view of the banks' economic, social and environmental issues as built into the banking business. Other specialised reports provide details on how banks are responding to shifting business demands, including changing workforce dynamics; accessibility of banking products and services for regional/remote communities, people with disabilities, households with low incomes, etc; increasing regulation of financial services; climate change; and socially responsible investing. Essentially, reporting on corporate responsibility acknowledges diverse stakeholder interests and how the banks are responding to these views.

Australia's banks have been recognised internationally and domestically for their corporate responsibility leadership, as reflected in the high ratings against corporate responsibility performance of a number of indices, including the Dow Jones Sustainability Index, FTSE4Good Index, Governance Metrics International Global Governance Ratings, RepuTex SRI Index and the St James Ethics Centre Corporate Responsibility Index. These indices seek to measure the performance of companies and their corporate responsibility practices.

Corporate responsibility can contribute to a company's competitiveness by enhancing management accountability, transparency and resourcefulness as well as improving business processes, procurement and distribution. However, while the ABA considers that the interests of other stakeholders are key to business performance, the degree to which a company may have regard for other stakeholders will depend on a number of factors; such as the nature of their business activities, the different business models and industry sectors, and the different operational issues impacting their stakeholders.

Therefore, it is reasonable that a company may, and should, have regard for the interests of stakeholders in different ways, reflecting the importance of particular business activities, the interests of shareholders and other stakeholders and the relationships between the company, its business practices and the wider environment in which it operates.

In summary, the ABA believes that:

- Corporate decision makers in Australia already have regard for the interests of stakeholders, as reflected in the wide range of activities in corporate Australia that can be described as “corporate responsibility”. For example, banks already have in place comprehensive corporate responsibility activities and stakeholder engagement programs that acknowledge the importance of their employees, customers, suppliers, the environment and the wider community. Therefore, the ABA disagrees with the sentiment that directors and companies are only interested in maximising short-term profits for shareholders at the expense of long-term performance and wider stakeholder interests.

- Generally companies can only be successful in the long-term if they broadly take into account their business impacts on their stakeholders. Companies should be responsible for their decisions as they impact on stakeholders, as these decisions will inevitably impact overall financial and operational performance.

- Australia's banks have demonstrated that an important part of making corporate decisions and developing competitive advantage is about delivering shareholder value through business efficiencies and strategies that take into account broad shareholder and non-shareholder interests. Corporate responsibility represents a perspective on delivering value to shareholders, involving a corporate mindset that goes beyond current financial reporting and internally focused governance and risk management to generating long-term sustainable performance.

3.2 Examples of corporate responsibility in Australia's banking industry

Financial literacy and financial inclusion programs provide opportunities for banks to work in close partnership with community and welfare groups to deliver better accessibility to banking products and services, particularly for the more disadvantaged groups within the community.

Financial literacy

Financial literacy is the ability to make informed judgements and effective decisions about the use and management of money[7]. Australia's banks are responding to issues of financial literacy in various ways, ranging from research into the level of youth and adult financial literacy in Australia, development of financial literacy education for school-age children and partnerships with financial counsellors and community groups to deliver financial literacy training to low income families.

Some banks financial literacy programs include:

- An adult financial education workshop program facilitating training for financial counsellors and community educators to assist people, particularly low-income households, to build their financial skills and knowledge and make informed decisions about their money. The program was developed in collaboration with a number of financial counseling groups.

[7] Definition of “financial literacy” from the UK National Foundation for Educational Research, 1992.

- A student banking program providing fee-free banking accounts to encourage young people to save. The program is conducted in partnership with schools and teaches young people the principles of banking and sound money management. A website facility also offers young people objective and unbiased financial management information on a range of important money management topics, including saving, budgeting, borrowing, lending, jobs and money. The facility features a number of interactive tools to enable more informed financial decisions.

- A student education program providing a resource for teachers to use as part of their teaching modules to improve young Australians financial literacy. The program is mapped to every state's curriculum.

- A grants program for primary and secondary schools to develop literacy, numeracy and financial literacy education programs.

- A national assessment tool for students so that they can identify aspects of their financial knowledge that are strong and those that could be improved.

- A one-day financial literacy workshop for 16-25 year olds, offered throughout rural and regional Australia. The workshop provides young people with the opportunity to develop skills for making informed decisions about using and managing money, saving, budgeting, investing, managing debt, and being entrepreneurial.

- A financial literacy curricula resource package providing support and assistance to teachers to improve the knowledge, skills and understanding of their students in the area of financial literacy. The curriculum resources apply across primary school-aged and high school-aged students and have been developed with the assistance of the NSW Department of Education and Training and community groups.

- An education workshop developing understanding of employees, customers and members of the community around basic financial matters and advice. The workshop includes information on basic financial literacy but specifically looks at how to apply critical thinking to financial decisions, including activities on budgeting, ways of paying off debt and the advantages and disadvantages of various credit, store and charge card options, and where to go for help when they get into financial difficulty.

- An Indigenous community money management skills and savings program that includes financial literacy workshops and training on topics relevant to the individual community. This program has been introduced in collaboration with Government, local community and Indigenous community groups.

Other financial literacy programs provided by banks include guides on using credit cards, managing finances online and making banking easier for small business and older Australians.

In addition to individual banks' financial literacy activities, the ABA's financial literacy program involves three key areas:

- Information dissemination program: objective to enhance distribution and delivery of existing and new materials in collaboration with partners.

- Awareness and access program: objective to increase awareness and access to ABA and banks' own financial literacy materials and programs.

- Materials development program: objective to continue to develop generic materials and resources to promote 'responsible spending leadership'.

The ABA's financial literacy program seeks to build on the work of ABA member banks and advocate the importance of financial literacy within the banking industry. Some highlights of the program include the 'Broadening Financial Understanding Workshop' and the 'Smarter' booklet series ('Smarter Banking: Make the most of your money'; 'Smarter Banking: Make credit work for you'; and 'Smarter Super: Make the most of your retirement').

In addition to individual financial literacy initiatives, the ABA and some member banks are working closely with the Government's Financial Literacy Foundation.

Financial inclusion

Inclusion is about addressing potential problems with access to financial products and services because of a range of factors, such as physical, geographic, cultural or financial, to assist in improving the quality of life for members of the community. Financial inclusion aims to address financial exclusion, which is the lack of access faced by the most needy members of the community to low-cost, fair and safe financial products and services from mainstream financial services providers[8].

Financial inclusion programs seek to assist low-income consumers address issues such as low savings levels, unsustainable levels of personal debt and financial stress. Australia's banks are responding to issues of financial exclusion in various ways, including research on the size and nature of financial exclusion (seeking to address the needs of those excluded from mainstream financial services) and development of programs that assist low income consumers save, manage their debt obligations and deal with financial hardship.

Some banks financial inclusion programs include:

- A matched savings program to assist low income families save money for their children's education by matching every dollar saved for the purpose with $1, up to a maximum of $1000. The program was developed in conjunction with a welfare organisation and has been extended through an additional welfare organisation partnership.
- Micro-credit schemes and no interest loan schemes pooling resources and returning to the community to assist people on low incomes. A number of banks have developed programs in partnership with Government, welfare organisations, community groups and consumer groups. For example:
    - Community development finance programs involve small loans for enterprise development.
    - Micro-credit schemes involve making loans of between $300 and $1000 to disadvantaged people to obtain access to funds for essential personal and household goods (e.g. white goods). In addition, the scheme provides people with basic financial planning and budgeting advice.
- A "Low Interest Loan" program involves making loans of between $800 and $3000 to low income consumers at a fixed rate. These loans provide affordable credit for the purchase of essential household goods and services. In addition, the program assists consumers to establish a credit rating and gain entry into the mainstream credit system. Loans are tailored to the needs of people on low incomes who are currently using 'payday' lenders and other fringe credit providers. Successful applicants for the low interest loan program are monitored by dedicated officers that, throughout the loan process and repayment period, offer support and access to information and referral services.

[8] Definition of "financial inclusion" from research conducted by Chantlink Associates for ANZ, 2004.

- An Indigenous community and regional banking program assisting local community representatives to help community members in opening bank accounts to receive financial entitlements. The program has been designed to support individuals with limited English ability and has been implemented in partnership with Indigenous community groups. The program has also conducted research investigating lending on communal land. The program seeks to assist with strategic management of Indigenous land assets in a culturally appropriate manner to generate sustainable financial outcomes for the local community.

- Low fee basic bank accounts and low interest credit card products involve providing access to banking products and services that minimise the impact of transaction costs for disadvantaged and low income households.

Banks stakeholder engagement programs and corporate responsibility activities aim to help build social capital and empower local communities. Activities designed by banks to assist in addressing problems with financial exclusion are break even products seeking to make a difference for people that may otherwise not be able to access credit for household necessities. Importantly, these programs have been able to progress and evolve in a competitive banking sector environment.

In addition to individual financial inclusion initiatives, the ABA and some member banks are working closely with the Government's Financial Wellbeing Taskforce and Department of Families, Community Services and Indigenous Affairs.

For further information on the ABA's financial literacy program and member banks financial literacy activities and stakeholder and community programs, see http://www.bankers.asn.au or individual banks' websites.

4. Directors' duties: current position

4.1 Does the current legal framework constrain directors from taking into account the interests of particular groups or broader community considerations when making corporate decisions?

Under both the Corporations Act and common law, directors have a duty to act in the best interests of the company. In addition, to duties based on a directors' fiduciary relationship with the company, companies must also meet a wide range of Commonwealth, State and Territory statutes regarding occupational health and safety, anti-discrimination, industrial relations, equal opportunity, consumer protection and environmental impact as well as adhere to international covenants. It is the ABA's view that clearly identifiable minimum standards are best dealt with in these particular statutes, particularly as the minimum standards then apply across the business sector and not just to corporates.

> *Australian courts have successfully applied directors' duties to different circumstances and adopted the law where appropriate (for example, gradually increasing the standard of care and diligence expected of directors as community expectations have increased). Importantly, the existing law allows directors to consider the interests of stakeholders other than shareholders … A fundamentally important issue is how directors balance the interests of various stakeholders in the company and the role of the law in this process*[9].

In March 2003, *ASIC v Rich*, the New South Wales Supreme Court held that a court's role in determining the liability of a defendant for their conduct as director is to articulate and apply a standard of care that reflects "contemporary community expectations". Therefore, directors' duties involve exercising care, skill and diligence in the best interests of the company, that being the company as a whole, reflecting wider expectations.

[9] Ramsay I (2005). *Directors' Duties and Stakeholder Interests.* Company Director. 21 May 2005.

Section 180(1) of the Corporations Act 2001 provides that a director must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise. In addition, under section 181 a director must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.

Section 180(2) provides that a director meets their duty of care and diligence where they make a business judgement that is in good faith for a proper purpose (i.e. without material personal interest), that they inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate, and that they rationally believe the judgment is in the best interests of the company.

Business judgment means a decision to take or not take action in respect of a matter relevant to the business operations of the company. The "business judgment rule" was introduced to protect directors in the exercise of their duties and to give directors confidence to engage in entrepreneurial or informed decision-making that takes into consideration the wider interests of the company and the company's long-term performance.

What does it mean to act in the "best interests of a company"?

Some commentators believe that acting in the best interests of a company is to act in the best interests of the owners of the company (i.e. the shareholders). However, the statutory obligation is that directors are to act in the "best interests of the company". In fulfilling their duty to the company, arguably directors must consider the interests of both existing and future shareholders, and this means the long-term sustainability, not just short-term profitability of the company. Broadly, this requires directors to balance the short-term and long-term interests of the company as well as to consider the internal and external governance of the company.

It is the ABA's view that directors may make decisions in good faith and for a proper purpose that substantially benefits the community, consumers and the environment. Where there is lack of regard for the company or where no attention is paid to the interests of the company's shareholders, then this would likely be a breach of the duties of the Board. However, to ignore the interests of other stakeholders would also likely not be acting in the best interests of the company, as disregard is likely to expose the company to business risks.

Should the Corporations Act be revised?

A *mandatory provision* would *oblige* directors to have regard for the interests of groups other than shareholders in making decisions; whereas a *permissive provision* would *explicitly allow* directors to have regard for the interests of groups other than shareholders in making decisions. The matter of a mandatory or permissive provision for directors' duties was considered by the Senate Standing Committee on Legal and Constitutional Affairs. The report of the Committee noted that:

> *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 [shareholders]) directors' fiduciary duties could be weakened, perhaps to the point where they would be essentially meaningless*.[10]

[10] Senate Standing Committee on Legal and Constitutional Affairs (1989). *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*. November 1989. (para 6.51)

The primary duty of a director is to act in the best interests of the company and it is a matter for the Board to determine, when, and to what extent, stakeholder interests should be taken into account. Directors should have the ability to balance competing interests from time to time.

The objective of the law should be clear and without unnecessary burden that can stifle corporate innovation, business opportunity and economic growth. The law should also be responsive to today's business and community needs and be capable of being flexible towards tomorrow's business and community expectations.

A redefinition of directors' duties is problematic. In determining how such a provision might look, two fundamental questions need to be considered.

1. Is it appropriate for directors to be required to comply with regulations that guide what are appropriate social causes for their companies?

2. What limitations would need to be imposed to ensure that shareholders and investors are not discouraged from placing their capital with corporates?

Whether directors' duties should continue to be defined in terms of the best interests of the company or whether duties should be statutorily widened to other stakeholders with potential for redress if their interests are not being served must be considered in terms of existing business practices by corporate Australia within the current legal and regulatory framework.

The ABA makes the following points:

- While in law it may be that directors' duties are to "the company" (the existing and future shareholders of the company), in practice, with the day-to-day management of the company, directors are already considering a wide variety of interests when making strategic and operational decisions. Indeed, not considering these wider interests would arguably be not acting in the best interests of the company.

- If the proposition that shareholder interests can only be served by maintaining a standard of care reflecting "contemporary community expectations", then managing financial and non-financial risks and disclosing financial and non-financial performance means that companies already have regard for the broader interests of other stakeholders and already have available mechanisms for disclosing their responsible business practices to the market.

What are "broader interests"?

It is important for directors' duties in company law to be drafted so that it balances providing directors with certainty regarding their obligations, yet allows the law to respond to changing business and community needs. It is the ABA's view that section 181(1) of the Corporations Act is broad enough to allow directors to have regard for the broader interests of shareholders and other stakeholders, yet is clear in that it provides that a director has a duty to act in the "best interests of the company". It is difficult to envisage how a provision could adequately capture the nature of corporate responsibility without confusing directors' duties.

Amending the Corporations Act to contain a *mandatory provision* may unduly restrict the way in which corporate decisions are made, to the detriment of shareholders and other stakeholders. A mandatory duty is likely to result in a compliance approach to corporate responsibility; a 'tick the box' approach, which is not desirable and defeats the spirit and intent behind the concept of corporate responsibility.

The ABA believes that company law affords ample latitude for directors and companies to act responsibly *vis-à-vis* the environment and society generally. There are also other legal and regulatory obligations, market rules, industry standards, codes and industry practices that necessitate directors and companies having regard to stakeholder interests as part of their duty to act in the best interests of the company. The long-term performance and sustainability of the company requires prudent management of a wide range of business risks. Failure to measure and manage financial and non-financial risks will inevitably damage the company. Certainly as part of corporate decision making, the Board should contemplate the business risk of not considering how the company may impact on its internal and external stakeholders.

Furthermore, the ABA believes that the law already permits corporate decision makers to have regard for stakeholders in addition to shareholders. Therefore, amending the Corporations Act to contain a *permissive provision* is unnecessary and unlikely to result in changes to corporate behaviour or lead directors to make decisions differently to the decisions they make now. Alternatively, a permissive provision may even result in directors being unable to make efficient and effective corporate decisions to the detriment of shareholders and other stakeholders.

Creating a legal requirement to take into account other stakeholder interests creates a risk that the legitimate decisions of the Board and management of the company may be challenged by small minority interests that are not in the interests of the company or its primary responsibility. A minority interest may not be in the best interests of the majority of stakeholders. There is a risk that directors will be distracted by vexatious litigation instead of concentrating on managing the company in the interests for which they have been given permission to do so by their owners. A statutory obligation may in fact narrow the focus of the Board and management of the company creating inefficiencies in company operation and management; ultimately to the detriment of shareholders and other stakeholders.

Acting in the best interests of a company does not restrict directors from focusing beyond maximising short-term profits and shareholder wealth when making corporate decisions. Indeed, taking a broader view that is not inconsistent with the interests of the company that creates long-term value is indeed acting in the best interests of the company. Failure to manage wider stakeholder interests may adversely harm the company. Therefore, the ABA considers that the duties of directors to exercise reasonable business judgement can enable and encourage directors to discharge a standard of care that takes into consideration the interests of shareholders and other stakeholders.

The ABA does not support an amendment to the directors' duties to include a mandatory duty to act in the best interests of other stakeholders. Nor does the ABA support an amendment that explicitly allows directors to take account, where appropriate, of the interests of other stakeholders. Such a general response is likely to have a number of significant unintended consequences:

- Potentially diluting responsibility across a myriad of interests, rather than clarifying responsibility of directors;
- Stifling corporate innovation rather than encouraging 'enlightened shareholder value'[11];

[11] The ABA notes that clause 156 of the UK Company Law Reform Bill 2005 seeks to introduce a concept of 'enlightened shareholder value'. The Bill proposes to introduce a duty for directors to have a primary obligation to benefit shareholders, but explicitly states that this can be achieved by taking due account of other stakeholder interests. It is the ABA's view that the draft UK legislation seeks to implement practices for directors that are already generally contained in the Corporations Act. The ABA also notes that debate within the UK Parliament is casting possible doubt as to whether this section of the Bill will proceed. Adams, C (2006). *Conservatives plan to water down company law reforms*. Financial Times. 1 February 2006.

- Confusing adoption of progressive ways of managing diverse shareholder and stakeholder interests; and
- Generating conformance rather than performance.

Do shareholders have adequate mechanisms to raise environmental and social issues with companies?

Section 249N(1) of the Corporations Act 2001 states that the following members may give a company notice of a resolution that they propose to move at a general meeting:

(a) members with at least 5% of the votes that may be cast on the resolution; or

(b) at least 100 members who are entitled to vote as a general meeting.

Once the threshold requirement has been met, a resolution, which could be regarding environmental or social issues, may be taken to a general meeting.

The ABA notes that section 250S of the Corporations Act requires the chair of an AGM to allow reasonable opportunity for members as a whole at the meeting to ask questions about, or make comments on, the management of the company. This is perhaps more relevant as a current mechanism for allowing shareholders to raise issues with the company than section 249N(1).

In summary, the ABA believes that:

- It is important for shareholders to have effective mechanisms to examine the affairs of the company and engage with the management of the company. Shareholder participation is essential for ensuring transparency of a company's business activities and accountability of a company's board and management. Shareholders already have adequate mechanisms for examining the affairs of a company.
- Legislative amendment to prescribe a duty to require directors to take account of other stakeholders as part of their statutory duty to the company could confuse the role of directors, resulting in less efficient decision making to the detriment of shareholders and other stakeholders.
- Government intervention could have adverse consequences for innovation and creativity in corporate responsibility practices, and therefore is impractical, unnecessary and potentially counterproductive.

5. Corporate reporting: current practice

In Australia there is a mix of mandatory and voluntary measures to promote responsible business practices and consideration of wider stakeholders interests, including statutory and non-statutory corporate reporting requirements. Australia's banks currently disclose information to shareholders and other stakeholders through annual reports, financial statements, market announcements, product disclosure statements, financial services guides, press releases, market presentations and other documents, including CSR-type reports.

5.1 Corporate reporting requirements in Australia

Corporations Act

Most companies and registered managed investment schemes are required to prepare and file with the Australian Securities and Investments Commission (ASIC) an annual report. An annual report must contain, amongst other things, a financial report and a directors' report.

A director's report must include general information about operations and activities. The recently introduced Management Discussion and Analysis (MD&A) obligation requires directors to include quantitative and qualitative information about the operations and activities of the company pursuant to section 299A of the Corporations Act. The MD&A must contain information that shareholders would reasonably require to make an informed assessment of the operations of the entity during the reporting year; the financial position of the entity and any significant changes in the activities and the nature of the activities during the reporting year; and the entity's likely operational developments and the prospects of those operations in future financial years.

The introduction of this additional disclosure requirement is designed to maximise the usefulness of annual reports to all users, particularly people who are unfamiliar with reading and understanding financial reports, and is similar to the Review of Operations and Activities disclosure that is required by ASX Listing Rule 4.10.17. The MD&A obligation aims to ensure greater transparency and accountability within the company's operations and greater opportunity for all shareholders to take an informed role in the company business and other stakeholders to take an interest in the business operations of the company[12].

The ABA considers that the existing MD&A obligation, coupled with other corporate governance disclosure (periodic and continuous), provides adequate scope for directors and companies to report their financial and operational performance. The ABA notes that there is no statutory "safe harbour" for directors pursuant to section 299A.

ASX Listing Rules

Beyond the mandatory statutory disclosure requirements, each listed company (or disclosing entity) is obliged to meet the continuous disclosure requirements set out in Listing Rule 3.1. (A similar requirement applies to unlisted disclosing entities in section 674(2)(c) of the Corporations Act.) The continuous disclosure obligation requires a company to disclose any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities.[13] This requirement would reasonably cover information regarding environmental and social matters that satisfies the materiality test, particularly as issues, such as climate change, become increasingly important for companies and the wider community.

[12] The ABA notes that the MD&A obligation is similar to the obligation on UK listed companies, which are required to discuss broad strategic and forward-looking issues in their annual report as part of the Operating and Financial Review (OFR). The OFR essentially seeks to promote an effective dialogue on key drivers of long-term company performance. However, while the OFR obligation is mandatory, in May 2005 the Accounting Standards Board issued a reporting standard for the OFR obligation, which enables directors to determine how best to structure their review, in the light of the particular circumstances of the company. The ABA also notes that the UK Government is considering removing the statutory requirement for listed companies to publish an (OFR). In the absence of a "safe harbour", directors may be exposed to shareholder litigation. Thornton, P (2006). *Ministers in U-turn over review aspect of corporate reporting rules*. The Independent. 3 February 2006; and Jopson, B (2006). *Directors need safe harbour on forward looking statements*. Financial Times. 9 February 2006.

[13] ASX Listing Rule 3.1 and sections 674-678 of the Corporations Act.

In addition to continuous disclosure obligations, listed companies have obligations regarding corporate governance practices and disclosure of those practices. Pursuant to Listing Rule 4.10, companies listed on the Australian Stock Exchange (ASX) are required to comply with the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* by providing a statement in their annual report disclosing the extent to which they have followed the best practice recommendations during the reporting period. Importantly, the best practice recommendations focus on an "if not, why not" approach; where companies must identify the recommendations that have not been followed and give reasons for not following them.

Principle 10

"Recognising the legitimate interests of stakeholders" (Principle 10) sets out that companies have a number of legal and other obligations to non-shareholder stakeholders. It also recognises that increasingly, the performance of companies is being scrutinised from a perspective that recognises other forms of capital, such as natural, human and social capital. This being the case, the ASX Corporate Governance Council has determined that it is important for companies to demonstrate their commitment to appropriate corporate responsibility practices. Companies are required to establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

Furthermore, it suggests that directors have a responsibility to set the "tone and standards of the company" and to oversee adherence to these standards. A code of conduct, which states the values and policies of the company, can assist the directors in taking into account the interests of stakeholders as well as complement the company's risk management practices. Importantly, the best practice recommendations refer to "legitimate" stakeholders. Not all stakeholder interests will be relevant in all circumstances, and therefore it is reasonable for directors to retain the discretion to determine how best to balance the particular stakeholder interests.

Principle 7

In addition to Principle 10, the best practice recommendations identify the importance of identifying and managing risk. "Recognise and manage risk" (Principle 7) sets out that companies should establish a sound system of risk oversight and management and internal control to identify, assess, monitor and manage risk and inform investors of material changes to the company's risk profile. The risk profile of a company should be a description of the material risks facing the company, including financial and non-financial matters. A structure for managing risks can enhance the environment for identifying and capitalising on opportunities to create value and as such the concept of managing risk takes on a wider perspective than merely managing financial risks, to also managing operational risks. Importantly, the best practice recommendations refer to financial and non-financial risk management, and that these risks will vary across different companies and different industries.

The ABA considers that the best practice recommendations explicitly and implicitly require listed companies to have regard for the interests of other stakeholders as demonstrated by the conduct of the business, its operational activities and its risk management practices as part of its corporate governance framework. Considering the breadth of financial and operational risks inherently must involve a consideration of how the company interacts and engages with its shareholders and other stakeholders.

Standards Australia

In addition to corporate governance standards that apply to listed companies as contained in the Corporations Act or ASX Listing Rules, Standards Australia has published a series of Australian Standards to assist all companies develop and implement effective corporate governance practices. The Australian Standards are non-prescriptive and have been designed to apply across company-type; small or large, public or private, profit or not-for-profit. AS 8003 was published in July 2003 and provides guidance on corporate social responsibility.

In addition, Standards Australia has published a number of other standards for business, including risk management, compliance programs, OH&S, environmental management, security management, organisational codes of conduct, etc, to assist companies to meet their legal obligations as well as implement more broadly corporate governance structures and responsible business practices.

5.2 Bank-specific conduct and disclosure obligations

For banks, the Corporations Act not only contains fiduciary duties for directors, but also a statutory duty for the bank to ensure that its services are provided in an efficient, honest and fair manner pursuant to section 912(A). Banks have additional conduct of business obligations pursuant to their Australian Financial Services Licence and must have adequate organisational capacities, competent responsible officers and risk management systems to comply with the conditions of the licence and the financial services laws. Obligations to manage conflicts of interest also mean that banks must avoid, control or disclose any conflicts of interest pursuant to section 912(A). Licensed financial service providers that have a fiduciary relationship must act in the best interests of their clients. A similar obligation to act in the best interests of clients is also contained in the *Superannuation Industry (Supervision) Act 1993*.

In addition to conduct of business obligations, a bank must also meet certain prudential requirements to be authorised to carry on banking business pursuant to the *Banking Act 1959*. Part of these prudential requirements is to meet certain corporate governance and risk management standards. Directors and senior managers are also to meet certain fitness and propriety standards. The Basel capital framework sets out a comprehensive risk management methodology for retail and commercial banking business. Banks must have adequate systems for managing credit risk, market risk and operational risk as well as adequate capital to protect the business from these risks. The Basel Committee on Banking Supervision has provided guidance on sound practices for managing and supervising operational risk as well as sound corporate governance practices (based on the OECD *Principles of Corporate Governance*).

Managing business risk, by having regard for internal and external risks, and maintaining a prudent governance structure by having in place robust and transparent operational practices, is an integral part of the day-to-day management of a bank. Reputational risk is increasingly important for banking business. Effective governance practices are essential to sustaining public trust and confidence in the banking system, which are critical to the functioning of the banking sector and economy as a whole. The ABA considers that banks are obligated to have regard for managing all risks to the business as part of their prudential management and conduct of business. Understanding financial and operational risks is part of a sound risk management system.

Australia's retail banks are also subject to the uniform *Consumer Credit Code.*

Code of Banking Practice

The ABA's *Code of Banking Practice* was first published in August 2003, with revisions subsequently made in May 2004. The Code is voluntary[14] and sets standards of good banking practice when dealing with people, who are, or who may become, individual and small business customers. The Code includes key commitments, general obligations, principles of conduct and disclosures. The banking industry is dedicated to continuously work towards improving the standards of practice and service in the banking industry. Within the Code is a commitment to act fairly and reasonably towards customers in a consistent and ethical manner.

Customer service protocols

In addition to the *Code of Banking Practice*, each member bank will maintain its own customer service protocols. Banks have customer service charters, and some banks have more specialised procedures, such as Disability Action Plans, for addressing particular customer needs. However, a customer-focused culture can generally be demonstrated by principles of:

- Respecting and knowing customers;
- Understanding customer's needs and offering suitable solutions;
- Delivering consistently high standards of service;
- Working to build relationships with stakeholders (including customers, investors, financial advisers, business partners and the community); and
- Acting honestly and prudently and complying with legal and regulatory obligations.

Acting fairly and reasonably towards customers in the banking industry is essential in securing the long-term viability of the business. Therefore, acting in the best interests of customers is consistent with being accountable for corporate actions in the broader environment and community.

In summary, the ABA believes that:

- Current statutory obligations and industry standards encourage directors to have regard for the interests of shareholders and other stakeholders, where it is determined that such interests are also in the interests of the company.
- Corporate decision makers are not constrained by the existing framework. The law does not impede directors or companies from taking account of the interests of other stakeholders. Fostering relationships with shareholders and other stakeholders is an integral part of the existing legal, regulatory and corporate governance framework in Australia.

[14] Details of the 13 banks that have subscribed to the ABA's *Code of Banking Practice* are on the ABA website. http://www.bankers.asn.au

5.3 *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities? Should there be any changes to the ASX Listing Rules to require disclosure of non-financial information to the market?*

It is important to recognise that for companies to deliver greatest value for all stakeholders, a "one size fits all" approach does not adequately recognise the diverse and complex needs of all stakeholders. A "one-size-fits-all" approach to corporate responsibility or sustainability reporting will not work due to the uniqueness of each business and the variation in strategic approach across companies. The dynamics of the relevant industry, market sector, operating environment, product or service means that each company is different. The real and comparative influence of, and priority assigned to, varying stakeholder interests will be different.

Therefore, notwithstanding the wide recognition of the GRI guidelines, the ABA believes that it is premature to prescribe a particular reporting framework for companies to report against the triple bottom line. It is reasonable to expect that companies will determine that some aspects of economic, social and environmental reporting will provide a view of the operations of the company in its totality. However, it is unreasonable to suggest that all companies will have governance practices to report against all possible criteria, nor responsibilities to all possible stakeholders. Therefore, it would also be impractical to attempt to capture certain performance criteria or reporting indicators in either the law or listing rules.

The ABA notes that The Hon. Ian Campbell, Minister for the Environment and Heritage has approached the ASX Corporate Governance Council to consider incorporating sustainability reporting into the best practice recommendations[15]. The ABA also notes that CPA Australia and the AASB have both indicated that they are considering triple bottom line accounting standards for listed companies in Australia. Any Government intervention or legislative amendment that pre-empts the findings of the triple bottom line accounting discussions would be amiss. The ABA considers that it is preferable to allow reporting to evolve rather than mandating format and timing of reporting through legislation.

The ABA does not believe there to be a systemic failure of corporate Australia to address market and social forces by giving due consideration to the broader interests of the company as part of corporate decision making. Legislative intervention is not required, nor desirable, to enable or encourage directors and companies to have regard for the interests of other stakeholders. Modern governance, commercial practices and business necessity means that directors and companies already take into account wider interests in making decisions about corporate strategy and actions.

Importantly, Australia's existing framework appropriately ensures that the approach to practices and reporting is scalable to company-type. Ultimately, attempts to prescribe corporate responsibility will either be too high level to provide practical guidance across the various industry sectors and various companies, and therefore unenforceable, or will be too complex and prescriptive engendering a compliance-based response that is likely to narrow innovation in corporate responsibility.

Australia's banks have played a significant role in leading developments with corporate responsibility developments; in a voluntary capacity. The high level of corporate responsibility activity by Australia's banks demonstrates that Government intervention or legislative amendment is unnecessary in order to promote responsible business practices and responsible disclosure of those business practices.

[15] Department of the Environment and Heritage (2005). *Submission to the PJC Inquiry on Corporate Responsibility*. (p2).

In summary, the ABA believes that:

- It is not possible to codify all expectations that other stakeholders, including the wider community, may have of business, especially as these change over time.
- Additional regulatory measures that may impose additional compliance costs on companies without delivering tangible value are unnecessary.
- Directors duties' are already broad enough to allow directors and companies to have regard for the interests of other stakeholders.
- Australia's framework encapsulates corporate governance standards, corporate responsibility objectives, risk management reporting and good business practices that other jurisdictions are currently proposing or implementing to enhance existing frameworks.

6. Responsible business practices: partnership approach

6.1 Should Australian companies be encouraged to adopt socially and environmentally responsible business practices?

Corporate responsibility is not simply the space of large corporates or listed companies – it is about responsible business practices; "business responsibility". A corporation is only one way a business can structure itself. Indeed, corporate governance should also be "business governance". Therefore, it is important for the Government to endorse, encourage and facilitate responsible practices across all businesses, considering the nature and scale of their business operations.

6.1.1 Business initiatives

The ABA suggests the role for the business sector is to work to bring consistent recognition of corporate responsibility across their industry through competitive market driven responses to shareholder and other stakeholder interests. For example, a number of Australia's banks are involved in the United Nations Environment Program Finance Initiative (UNEP FI), a global partnership between the United Nations Environment Programme (UNEP) and the private financial sector. UNEP FI works with over 200 financial institutions who are signatories to the UNEP FI Statements, and a range of partner organisations to develop and promote linkages between the environment, sustainability and financial performance.

The ABA notes that an Australian bank is the current Chair of the UNEP FI Steering Committee. Its current work program is working on a number of key projects, including:

- *Climate Change*: focusing on carbon finance, national and international policy and regulation debates, and renewable energy.
- *Investment*: exploring how material social, environmental and governance considerations can best be incorporated into investment practice.
- *Sustainability management and reporting*: developing GRI Financial Services Sector supplement (environmental performance); building the business case for sustainability management and reporting in emerging economies.

In addition, to enhance dissemination of information about responsible business practices and to promote assessment of practices adopted by listed companies, the ABA suggests a number of possible initiatives.

Enhancing dissemination of information

An initiative similar to the London Stock Exchange's Corporate Responsibility Exchange may provide a mechanism for the consistent collection and dissemination of information about financial and non-financial performance of listed companies in Australia.

While this may assist smaller companies, it should be noted that the banking industry currently discloses information about stakeholder engagement programs and corporate responsibility activities on individual banks' websites and in various corporate reports. However, an alternative mechanism for the collection and dissemination of corporate responsibility information may supplement existing dissemination practices. This market driven approach may also give greater credibility and rigour to benchmarks of corporate responsibility practices.

The ABA would envisage that such a mechanism would complement existing reporting and disclosure practices and would not impose additional regulatory burdens on listed companies. Experience in the UK suggests that this approach has reduced the burden on companies that receive many requests for information from market analysts, benchmarking researchers, etc.

Enhancing comparability of information

The GRI is an evolving process. A number of ABA member banks support the GRI; these banks are involved as the framework allows flexibility to tailor to suit business needs. Notwithstanding, the ABA believes that it is too early to mandate performance criteria or reporting indicators. However, there is a need for mechanisms like the GRI guidelines to allow analysts to compare and benchmark performance against a commonly accepted reporting framework. The ABA considers that initiatives, such as XBRL, may be useful in promoting greater comparability through electronic communication of business and financial data[16]. The ABA also notes that the GRI is considering digitising reporting, which would allow information to be delivered to analysts in a format that would allow information to be more readily compared.

6.1.2 Government initiatives

The ABA believes there may be an important role for the Government to further promote responsible business practices across Australia by acknowledging the efforts of corporate Australia that work with community and welfare groups to deliver value for the community. For example, the Prime Minister's Community Business Partnership acknowledges business-community partnerships through the 'Awards for Excellence' program. The 2005 national award for large business was given to the *Millers Point Youth and Employment Partnership*, which is a collaboration between 12 organisations, including Westpac. In addition, Citigroup Australia, in partnership with YWCA NSW, won the 2005 multi-state award for their *Finance First* project and National Australia Bank, in partnership with Good Shepherd Youth and Family Services, won the 2005 Victorian award for large business for their *Step Up* program.

[16] XBRL (Extensible Business Reporting Language) is an XML-based standard for financial information, reporting and analysis. It has been jointly developed by over 200 global companies and organisations. XBRL Australia is a member of XBRL International Inc. and is a joint venture of the Institute of Chartered Accountants in Australia and CPA Australia. It currently allows tags to be applied to financial data so that information can be easily handled by computer software. http://www.xbrl.org.au/

The ABA suggests the role for Government could be threefold:

- Endorsement and adoption of international covenants to further promote human rights, social welfare and environmental management in the interests of Australia's participation in the global community;
- Encouragement of corporate responsibility among Australian and foreign companies operating in Australia through business and community forums in the interests of raising awareness of how corporate responsibility may be relevant across industry sectors; and
- Facilitation of 'good for business' messages about corporate responsibility by conducting research into the contribution of corporate responsibility to long-term sustainability and competitiveness of companies as well as sponsoring awards programs to recognise excellence in corporate responsibility practices.

6.1.3 Education initiatives

The ABA believes there may also be an important role for the Government and the business sector to work in partnership to further develop responsible business practices across Australia. It is important for educational initiatives to foster theoretical and practical knowledge building in Australia's future business and government leaders. For example, RMIT's *Community of Practice: Ethics, Governance and Corporate Social Responsibility* consists of a diverse membership from across business and government. The aim of the group is to bring together practitioners in the field of ethics, governance and corporate social responsibility to identify issues from a practice perspective that may form applied research projects for the Graduate Business School. Overtime, students that have exposure to this form of skills and knowledge building will influence the manner in which business operates within Australia. The ABA is a member of RMIT's Community of Practice.

7. Conclusion

The value of corporate responsibility is in its voluntary nature, lifting best practices across the business sector. Attempts to codify or regulate will only stifle innovation and creativity of companies in balancing the interests of various stakeholders. A prescribed obligation will not encourage companies to adopt the 'spirit of the law', but merely comply with the 'black letter of the law'.

The value of sustainability reporting is in companies responding to shareholder and other stakeholder concerns and interests relating to social and environmental performance, as well as financial performance. Existing disclosure frameworks allow flexibility for companies to report those aspects of the business of interest to shareholders and other stakeholders as reflecting the relationships they have with their shareholders and other stakeholders.

Companies, including banks, should have flexibility in how they determine to govern and manage themselves, disclose their operational activities to the market and endorse responsible business practices. The wide range of activities that banks are engaging in demonstrates that it is not possible to legislate a single response to corporate responsibility. If the voluntary nature of corporate responsibility were removed, the likely result would be corporate cultures that meet compliance obligations or make insincere commitments simply to demonstrate conformance. Conformance necessarily would replace performance.

Therefore, the ABA suggests that the role for public policy in enhancing corporate responsibility across industry sectors is in promoting the transparency of credible corporate responsibility across business and the wider community. Disclosure of responsible business practices means that companies are accountable for the way they operate, how they manage corporate resources, and how they interact within the economy.

Companies are part of the community; therefore their long-term sustainable operation enhances shareholder value and community value. Furthermore, it is the ABA's view that a director that is not responsive to the broader interests of the company will expose the company to a number of business risks.

However, the over-emphasis on conformance, rather than performance, is already evident with the significant changes recently made to the corporations and financial services laws. Further regulation of companies or ambiguity for directors can actually impede the benefits of corporate responsibility; that is, the flexibility to deliver real outcomes that are relevant to the stakeholders of the company.

Building shareholder value through defined corporate strategies and by making voluntary commitments that go beyond regulated corporate requirements, may not just contribute to a better society, but can also lead to innovative practices for sustainable economic growth, increased profitability for companies and enhanced investor confidence. Australia's banks recognise the importance of corporate behaviour that reflects responsible business practices, corporate accountability and transparency and thus are recognised for their leadership in corporate responsibility amongst corporate Australia.

Australian Bankers' Association
8 March 2006

THE UNIVERSITY OF
MELBOURNE

22 February 2006

Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

SUBMISSION BY DR JOHN HOWE, CENTRE FOR CORPORATE LAW AND SECURITIES REGULATION, MELBOURNE LAW SCHOOL

Thank you for the opportunity to make this brief submission in response to the CAMAC Discussion Paper *Corporate Social Responsibility*.

I am a Senior Lecturer in the Faculty of Law at the University of Melbourne, and am a member of both the Centre for Corporate Law and Securities Regulation and the Centre for Employment and Labour Relations Law here at the Law School.

Introduction

1. This submission relates to Part 5 of the Discussion Paper, 'Encouraging Responsible Business Practices', and therefore addresses aspects of Question 3 of the CAMAC terms of reference.

2. In Section 5.6 of the Discussion Paper, consideration is given to Government initiatives to achieve corporate social responsibility, including promotion of responsible practices by government agencies. There is also a list of other possible initiatives (5.6.2), in particular, tailoring conditions through public procurement and tendering policies, and requiring participants in public-private partnerships (PPPs) to demonstrate that they follow appropriate business opportunities, and use of taxation and other fiscal measures.

3. In my view, more attention can be given to such measures as a technique by which governments can assist corporations to be more accountable or responsible to society.

Deployment of Government Wealth as a Regulatory Instrument

4. There is a rich international literature on the use of government deployment of public wealth to leverage corporate accountability to community standards, including environmental and labour standards.[1]

5. PPPs and public procurement programs are variations on the *"contracting out"* of previously public functions to private, voluntary or quasi-public providers.[2] They offer the potential for government to control activity utilising the exchange of public wealth for the provision of a good or performance of a service by a private actor.[3] The primary means by which the government secures the co-operation of an external actor is through the offer of a subsidy or fee, while a contract is generally the means of attaching conditions to, or "regulating" that subsidy. The external organisation consents to the attachment of these conditions because of the incentive provided by the contract payments. In the same way, external actors can be contracted to be conduits, or intermediaries employed to transfer government expenditure to its final recipient.

6. In addition to public-private partnerships and public procurement, consideration has also been given to the issue of corporate accountability to community standards in the context of government financial subsidies to corporations, or 'industry assistance'. [4] This is in part because the justification for such subsidies is normally their 'job creation' benefits for the economy.

7. Financial subsidies or incentives to corporations may take the form of cash grants, loans or tax discounts that are intended to reduce the cost to the private sector of compliance with behavioural patterns desired by government that the private sector might not otherwise follow.[5] The use of financial incentives as a regulatory instrument has been observed in a number of different areas of government activity, including job creation and environmental protection.[6]

[1] See, for example, Bovis C, "A Social Policy Agenda in European Public Procurement Law and Policy" (1998) 14 *International Journal of Comparative Labour Law and Industrial Relations* 137; Arrowsmith S, "Public Procurement as an Instrument of Policy and the Impact of Market Liberalisation" (1995) 11 *The Law Quarterly Review* 235; McCrudden C, "Using Public Procurement to Achieve Social Outcomes" (2004) *National Resources Forum* 25.

[2] On government use of contract as a regulatory instrument in Australia, see generally Davis G; Sullivan B, and Yeatman A, *The New Contractualism* (Macmillan, Melbourne, 1997); Seddon N, *Government Contracts: Federal, State and Local* (Federation Press, Sydney, 3rd edn 2002).

[3] See Hood C, *The Tools of Government* (Macmillan, London, 1983), pp 42-43.

[4] *Public Subsidies, Public Accountability: Holding Corporations to Labor and Community Standards,* (Washington DC: Grassroots Policy Project, Sugar Law Center for Economic and Social Justice, and Sustainable America, 1998); Baragwanath C and Howe J, *Corporate Welfare: Public Accountability for Industry Assistance* (The Australia Institute, Discussion Paper No. 34, Canberra, 2000).

[5] See, for example, Howse R, "Retrenchment, Reform or Revolution? The Shift to Incentives and the Future of the Regulatory State" (1993) 31 *Alberta Law Review* 455; Grabosky P, "Regulation by Reward: On the Use of Incentives as Regulatory Instruments" (1995) 17 *Law and Policy* 257.

[6] See, for example, Howe J, 'Money and Favours: Government Deployment of Wealth as an Instrument of Labour Regulation', in Arup C et al, *Labour Law and Labour Market Regulation: Essays on the Construction and Regulation of Labour Markets and Work Relationships* (Federation Press, Sydney, forthcoming early 2006). On the use of subsidies in the context of environmental policy, see Grabosky, *ibid*.

8. Notwithstanding that these instruments can be used to *promote* policy objectives through *market* mechanisms and *non-government* actors, they are nevertheless expressed and constrained by law. The types of legal measures used may range between administrative guidelines within the relevant government department or authority, through to government contracts, as well as other formal agreements or "quasi-contracts", and legislation.

9. Regulatory instruments such as financial subsidies and incentives are frequently portrayed as "soft" or "light-touch" regulation, as distinct from "hard" legal regulation often associated with legislative models of regulation.[7] Regulating by means of economic incentives is a technique by which governments have endeavoured to promote external satisfaction of public policy objectives where legal coercion is seen to be inappropriate or ineffective.[8]

10. In other words, a perceived advantage of the deployment of wealth as a form of state regulation of the private sector is the capacity of such instruments to be "responsive" to existing values and social ordering, thereby fostering a culture of compliance.[9] It is argued that by advancing policy objectives based on the ideal of social or redistributive justice in a way which avoids "intrusive interference with private social and economic arrangements and market allocation decisions", regulation is likely to be more effective.[10]

11. Further, in many jurisdictions these instruments offer a form of regulation which is less constitutionally restricted than legal regulation, and therefore able to be widely utilised by different levels of government, and, moreover, they may be used by the higher level government to regulate the behaviour of the other levels of government within the state hierarchy.

12. Thus, in Australia, there is evidence that social regulation based on the deployment of wealth is used by both State and Local Government, as well as by the Commonwealth.

13. For example, persons who supply or propose to supply goods and services to the Victorian Government must satisfy the requirements of an "Ethical Purchasing Policy" (EPP).[11] One of the principles which underpins this policy is stated to be the Government's "Ethical Employment Standard" (EES).

14. The EPP requires suppliers of goods and services to demonstrate "to the reasonable satisfaction of the government buyer" that the contracting or tendering

[7] The terms "soft" and "light-touch" regulation are frequently used in relation to legal instruments in Europe: see Dickens L, "Problems of Fit: Changing Employment and Labour Regulation" (2004) 42 *British Journal of Industrial Relations* 59.

[8] Gunningham N and Grabosky P (with Sinclair D), *Smart Regulation: Designing Environmental Policy* (Clarendon Press, Oxford, 1998), p 70; Ogus A, "New Techniques for Social Regulation"; in Collins H, Davies P, and Rideout R (eds.), *Legal Regulation of the Employment Relation* (Kluwer Law International, London, 2000).

[9] See further Parker C, Scott C, Lacey N and Braithwaite J, "Introduction", in Parker *et.al.*, *Regulating Law* (OUP, Oxford, 2004).

[10] Howse, "Retrenchment, Reform or Revolution", at 471.

[11] *The Victorian Government's Ethical Purchasing Policy: Supporting Fair and Safe Workpla*ces (Department of Treasury and Finance, State of Victoria, December 2003).

entity is meeting "its obligations to its employees under *applicable industrial instruments and legislation* at the time a contract is awarded and continues to meet such obligations during the term of that contract".[12]

Limitations of these approaches

15. The availability of these different instruments, and their apparent advantages, cannot be taken to mean that they have no disadvantages. Although such instruments may appear to be examples of *responsive* regulation in the sense that they avoid some of the problems associated with sanctions-based legal regulation, it is also necessary to consider whether they can also be *effective* regulatory mechanisms, especially where legal and non-legal forms of regulation interact.[13]

16. There is also a question about the transparency and *accountability* of deployment of government wealth as a form of regulation which must be addressed.[14] For example, even if these forms of regulation can be justified on the basis that they are effective in achieving policy objectives, questions can be raised about whether the ends to be achieved justify the means employed. Regulation of this character often avoids accountability mechanisms which would otherwise apply to legal instruments, mechanisms which are fundamental elements of a representative democracy.[15]

17. Part of the difficulty here is that State Governments often see themselves as being in competition to attract new investment or retain existing industries and businesses within their respective jurisdictions. Governments do not want there to be a perception that they impose more conditions on businesses than other States. This explains why governments often claim that contracts underpinning these sorts of arrangements cannot be released on the basis of 'commercial in confidence', when business is at times ambivalent about the release of some contractual details.

18. These issues must be addressed if government deployment of wealth is to be a legitimate mechanism for achieving greater corporate public accountability. However, assuming such problems (and I am sure there are others which must be addressed) can be overcome, these regulatory approaches can (and already do) have an important role in the effective achievement of greater corporate public accountability.

Concluding Remarks

19. There is evidence that the regulatory initiatives outlined above are already used to secure greater corporate accountability to public interest goals. However, there is a need for empirical research to be conducted which examines the incidence of social regulation through such approaches, and which is able to assess the

[12] *Ibid* (emphasis in document).
[13] Parker, Scott, Lacey and Braithwaite (eds.), *Regulating Law*; Parker and Braithwaite, 'Regulation'.
[14] See, for example, Baragwanath C and Howe J, *Corporate Welfare: Public Accountability for Industry Assistance* (The Australia Institute, Discussion Paper No. 34, Canberra, 2000).

[15] Parker and Braithwaite, "Regulation", p 124.

effectiveness of these approaches in changing corporate practices. Once this is done, it will be possible to identify ways in which these initiatives could be better utilised for promoting greater corporate social responsibility.

20. One obstacle preventing such research is a key problem confronting these initiatives – a lack of transparency and accountability. This frequently makes it difficult to determine the nature of conditions imposed or negotiated through such instruments, the extent of monitoring and evaluation of the effectiveness of these approaches in securing social goals, and the availability and use of sanctions in the event of non-compliance with conditions.

21. In conclusion, the initiatives discussed in this submission allow governments to play a role in securing greater corporate social responsibility and accountability without necessarily requiring prescriptive legal regulation. Greater attention needs to be given to such approaches, and how to resolve their limitations, in the debate over corporate social responsibility.

John Howe
j.howe@unimelb.edu.au
(03) 8344 1094

CORPORATE SOCIAL RESPONSIBILITY

Submission in response to the invitation of the Corporations and Markets Advisory Committee from Henry Bosch AO.

1. The Minister's first term of reference asks whether the Corporations Act should be revised 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.

Response:

The Act should not be revised for this purpose because directors already take the interests of legitimate stakeholders and the broader community into account and their right to do so is already generally understood. Legislative guidance is not only unnecessary but would impose rigid parameters which would be counter-productive.

I joined my first board [that of John Lysaght Australia Ltd – now part of Blue Scope Steel] in 1972 and, apart from the five years 1985-1990 when I was Chairman of the National Companies and Securities Commission, I have been a director ever since. I have served on over thirty boards and in the last sixteen years have advised scores of others. Moreover I have taught hundreds of groups of directors for the Australian Institute of Company Directors and for other bodies. I have never encountered a board that did not recognise the need to take account of the legitimate interests of stakeholders, and I have never heard it argued that such interests should not be taken into account, or that the existing law was an impediment to doing so.

All boards of which I am aware consider the company's interests in the longer term as well as the short term. Plans, whether they are called Strategic or Corporate or Business, are made in all but the smallest companies and directors look forward to planning horizons which are usually three to five years, but which may extend much further. While planning is done poorly in many companies there is always a recognition that, at least in the longer term, if the company does not look after its customers sales will suffer, if it is regarded as a bad employer it will be harder to recruit good people, if it doesn't pay its debts it won't get credit, and so on. Corporate reputation is a valuable asset and is seen to be so. These matters are almost always taken into account, at least to some extent, in making corporate decisions. Of course short term pressures sometimes prevail, particularly in times of crisis, but if they prevail for long the company will cease to exist.

This experience bears out the thrust of Section 1.3.3 of the Discussion Paper, with which I agree. See especially note 27 on page 12. Several other observations in the Discussion paper are also pertinent.

The fact that directors take account of the interests of genuine stakeholders and the reputation of their companies in the general community does not mean that everyone will always be satisfied. Taking into account is not the same as deciding in favour of. The interests of some stakeholders will always be opposed to those of others. For example, employees want higher pay, better conditions and secure tenure – all of which raise costs - while customers want lower prices, which require lower costs. Directors are, and will always be, forced to choose between different interests and the only realistic criterion on which they can base their decisions is the long term survival and prosperity of the company. Naturally those who contribute more to the company, those who are more important to its survival and prosperity, will find their interests given greater weight than those who contribute less. Those who would like to be considered stakeholders but contribute little or nothing to the company, such as casual passers-by, like Greenpeace, will always be disappointed and will always be calling for more CSR - by which they mean that they want their interests to prevail.

Professor Berle's comment, quoted at note 8 on page 5 of the Discussion Paper "You cannot abandon the emphasis on the view that business corporations exist for the sole purpose of making profits for their [shareholders] until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else" is absolute right. The muddled confusion which goes by the name of corporate social responsibility, and which the Advisory Committee cannot define [page 3], is a very long way from being a "clear and reasonably enforceable scheme of responsibilities".

In the last few years a great deal more attention has been paid to stakeholders, and to the supposed interests of the general community, than in the previous decade. There have been significant changes in social attitudes, and a large increase in media attention. In particular, environmental issues have received far more notice than they did a decade ago. It should not be assumed that the present foci of attention are permanent. Intellectual fashions change rapidly and legislators should avoid being trapped in the parochialism of the present. As the historian Lord Macaulay put it: "He alone reads history aright who, observing how powerfully circumstances influence the feelings and opinions of men, how often vices pass into virtues and paradoxes into axioms, learns to distinguish what is accidental and transitory in human nature from what is essential and immutable." The present fashion for corporate social responsibility and environmental concern is not the first [remember the Club of Rome in the 1970s and the pressures which led to the Senate inquiry in the late 1980s], and it is unlikely to last – at least in its present form. Refer to the note 6 on page 3 of the Discussion Paper ["The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century"].

2. The Minister's second term of reference asks whether the Act should be revised to **require** directors to take stakeholder or community interests into account.

Response:

The Act should not be revised for this purpose because it would undermine the accountability of boards. Unaccountable power tends to corrupt and there have been many instances in which managements and/or boards have done great damage [including harm to stakeholders and the community] as a result of pursuing their own interests. It is vital that the Corporations Act preserves the clear accountability of boards to some external entity able to hold them to account. Stakeholders and the general community are so diverse that they cannot perform this function. Over the last fifteen years there has been a rapid increase in the ability and preparedness of shareholders to act like owners and there is every indication that this trend is continuing. There are strong reasons for believing that it will continue. Clear responsibility to shareholders for the prosperity of the company in perpetuity is the essential basis of accountability and legislators would be very unwise to tamper with it.

Over the last two decades a great deal of progress has been made in developing corporate governance structures and procedures which reduce the likelihood and scope for the abuse of unaccountable power. A vital element of corporate governance is the recognition that managements are accountable to boards and boards are accountable to shareholders. For accountability to be effective there have to be criteria by which performance can be measured which are clear, simple and straight forward. There is still a lot more to be done in this area and it is important not to blur the issues.

Were directors required to take other interests into account their accountability to shareholders would be diluted and it would be difficult, if not impossible, to show that they were not acting properly. If profits fell it could be claimed that the board had had to give priority to the environment, and if the environment did not receive the attention its advocates wished it could be argued that some aspect of social justice had received priority. The Senate Standing committee on legal and Constitutional Affairs put this well in its 1989 Report "To require directors to take into account the interests of the company's employees, its creditors, its customers or the environment, as well as its shareholders, would be to require them to balance out what would on occasions be conflicting forces….it would also limit the enforceability of shareholders' rights if directors were able to argue that, in making a certain decision, they were preferring other interests." Paragraph 2.20. Other relevant quotations from the Senate Report are included in the Discussion Paper at Section 3.2.2.

The so-called Triple Bottom Line is a serious threat to accountability. Of course, in many cases it is only a public relations exercise but, if boards genuinely claim that their performance should be measured by three separate criteria, that amounts to a dereliction of duty. No common denominator has been, or could be, put forward which would enable the three criteria to be balanced, and being accountable by three independent criteria simultaneously means not being accountable at all.

3. The Minister’s third term of reference asks whether companies should be encouraged to adopt socially and environmentally responsible business practices and if so how.

Response:

Section 1.1 of the Discussion Paper outlines the difficulties with the concept of corporate social responsibility and on page 3 it is stated that the Advisory Committee does not propose to adopt a particular definition. That was wise. There are so many different groups with different agendas and concepts claiming to speak in the name of “Corporate Social Responsibility” that the only common denominator is a warm cuddly glow. [See the muddled nonsense included in note 3 on page 2 of the Discussion Paper in the names of Sustainability and the EU Green paper et al].

There is already a great deal of pressure on companies to adopt practices which are regarded as socially responsible by various groups. The emphasis of this advocacy will almost certainly vary as time goes on and circumstances change, and the Government would be well advised to stay clear of the issue. As Bernard Shaw commented [in “Major Barbara”] “For every man there is but one true morality, but every man has not the same true morality.”

4. The Minister’s fourth term of reference asks whether the Act should require certain types of company to report on the social and environmental impact of their activities.

Response:

The Act should not require special reporting. There is a very great deal of reporting already and it should not be increased because:

1. further reporting would increase business costs and thus add costs to ultimate consumers,
2. statutory requirements are rigid and unlikely to keep up with changing circumstances. They are often only a roadmap for the unscrupulous – they enable companies to comply with the letter while avoiding the spirit of the requirements.
3. reporting can be, and often is, very misleading. The Enron statement on Corporate Social Responsibility was one of the best published by any company but it turned out to have little connection with reality.

Henry Bosch
24th February 2006

Submission to CAMAC on Corporate Social Responsibility

1. Introduction

Whilst the terms of reference in the discussion paper seem limited to directors and "the positive role for Government", any contemplation for change in this area of the Corporations Act should also include the consideration and potential impact upon corporate insolvency law. This is crucial given its location as part of the corporate law statute and particularly given the role that external administrators perform within an insolvent company. It is somewhat surprising that the discussion paper has not specifically dealt with this subset of corporate law. My submission promotes extending the discussion to allow this to be considered.

Australia does not have a developed theoretical perspective on corporate insolvency. At best there is some agreement that certain principles influence good local insolvency law-making.[1] Given this absence it is apposite to contemplate corporate social responsibility as a potential 'candidate'.

The Australian corporate law has developed in a pragmatic and piecemeal way with different perspectives exerting varying degrees of influence in the present law.[2] It is rare to find these perspectives expressly stated as such conceptual frameworks tend to remain "beneath the text of the statute or judicial decision".[3] It is heartening to see the terms of reference requesting consideration and advice on such matters. As I have already indicated the subset of corporate insolvency law should not be omitted from this discussion.

[1] See, the principles of insolvency first listed as "aims" in Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988) ('the Harmer Report') para 1.

[2] Roman Tomasic, Stephen Bottomley & Rob McQueen, *Corporations Law in Australia 2nd ed*, (2002) 52.

[3] Ibid. The authors mention concession theory, aggregate theory, economic theories, natural entity theory, communitarian theory, feminist theories, corporate social responsibility, and an organisational perspective.

Internationally it has been argued that corporate insolvency law operates through a contractual perspective as its features are conveniently viewed as being grounded in contract.[4] This is understandable as the law of corporate insolvency focuses on the rights of creditors and the corporate debtor and such rights arise from the contractual relationship between these two.

In quite recent times, this dominant perspective of the contract in corporate law and its influence on corporate insolvency law has been challenged by a few scholars whose vision for these areas of law suggests the application of broader considerations. Such challengers have developed perspectives that go beyond contractual analysis to incorporate other factors such as a range of community interests, recognition of ethical issues and accepting multiple values can apply all matters that fit into a corporate social responsibility discussion.

This submission acknowledges the dominant perspective in corporate law and corporate insolvency law is not corporate social responsibility and yet advocates for the inclusion of the community and broader notions of influence on corporate insolvency law. Areas within corporate insolvency like the law of statutory priorities lend itself to such broader notions.

2. Creditors' bargain – insolvency's shareholder primacy perspective

The shareholder primacy that underpins the perspective leading to maximizing shareholder wealth could be substituted in an insolvent corporation by a requirement to act in the interests of creditors, creditor primacy, and to maximise their distribution from the estate. Over the last two decades one dominant model of insolvency law has been promulgated. This model is the creditors' bargain model and its asserts that the most prominent features of insolvency law are best seen as reflecting the notional agreement the creditors of the corporation themselves would strike if given the chance to bargain

[4] See, eg, Douglas A Baird & Thomas H Jackson, 'Corporate Reorganization and the Treatment of Diverse Ownership Interests: a Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 *University of Chicago Law Review* 97, Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (1986)

with each other before anyone lends anything. It is a perspective of an *ex ante* bargain for a collective regime.

The creditors' bargain model developed in the United States of America amongst discussion regarding the aims of insolvency law. It is by far the most developed of insolvency perspectives and while "currently rather unfashionable"[5] is the model that constitutes the "only sustained attempt at a principled analysis of the law governing bankrupt companies".[6] Its major advocate, Jackson,[7] proposes a restrictive view that insolvency law is to be analysed as collectivized debt collection law and the purpose of the law is the efficient coordination of the claims of creditors in order to enhance the value of the debtors' assets for all claimants. When diverse co-owners (creditors) assert rights against a common pool and achieve the same return as if the individual creditors had enforced their own claims[8] then this is known as the 'creditors' bargain'.

Jackson[9] and Baird[10], argue for the proper function of insolvency law to be seen in terms of a single objective that of maximising the collective returns to creditors as a group.[11] Jackson states that insolvency law should be seen as a system designed to mirror the agreements one would expect creditors to arrive at were they able to negotiate such agreements *ex ante*.[12]

The creditors' bargain perspective is argued to justify the compulsory, collectivist regime of insolvency law on the grounds that, if company creditors were free to agree to forms of enforcement of their claims on insolvency, they would agree to collectivist arrangements

[5] Rizwaan Jameel Mokal, *Corporate Insolvency Law Theory and Application* (2005) 34.
[6] Ibid.
[7] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (1986) 3.
[8] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 5 *Yale Law Journal* 857, 864.
[9] Jackson, above n 7, 25.
[10] Douglas G Baird, 'The Uneasy Case for Corporate Reorganisations' (1986) 15 *Journal of Legal Studies* 127.
[11] Douglas G Baird & Thomas H Jackson, 'Corporate Reorganisations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 *University of Chicago Law Review* 97.
[12] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (1986) 17.

rather than procedures of individual action or partial collectivism.[13] Jackson recognizes that this system is attractive to creditors as it reduces strategic costs and is administratively efficient.[14] The result is then a greater pool of assets. Finch concludes (and, in a way, Jackson admits it[15]) that it follows from this position that "the protection of non-creditor interests of other victims of corporate decline, such as employees, managers and members of the community, is not the role of insolvency law".[16]

3. The critiques of the creditors' bargain

Recently Cole wrote

> "When Thomas Jackson published *The Logic and Limits of Bankruptcy Law* in 1986 he framed virtually all bankruptcy scholarship that would follow for the next fifteen years…This "creditors' bargain" approach has divided the world of bankruptcy academics into two camps: the "Law and Economics" scholars who appear to adopt the creditors' bargain as the essential purpose of bankruptcy, and the "Progressives" who contend that the purpose of bankruptcy is to promote social welfare, ordering and redistribution that is not politically feasible through other means. The common pool, according to the Progressives, should be shared by more claimants than the Law and Economics scholars are willing to acknowledge."[17]

Critique of the creditors' bargain and its fostered parentage, the law and economics scholarship; have been heard from 'progressive' voices in the United States and the United Kingdom. The main United States of America critiques are presented by Warren[18]

[13] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle* (2002) 28.
[14] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (1986) 25.
[15] Ibid.
[16] Finch, above n 13, 28.
[17] Marcus Cole, 'Limiting Liability Through Bankruptcy' 70 *University of Cincinnati Law Review* 1245, 1251.
[18] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review* 775.

and Korobkin[19] while in the United Kingdom the most substantial work is presented by Finch,[20] and more recently Mokal.[21]

Warren[22] advances a case for consideration of wider interests that include employees and suppliers. She suggests that insolvency law is "more complex and ultimately less confined"[23] than proponents of the creditors' bargain such as Baird and Jackson might suggest. Warren uses Congressional comments on the United States of America's *Bankruptcy Code* to support "concerns broader than the immediate problem of debtors and their identified creditors".[24] Congress has stated that insolvency policies should have a public interest beyond the debtor and creditor.[25]

There is ready acknowledgment that the creditors' bargain perspective is attractive because it is straightforward and central; however Warren observes that this perspective can close off further inquiry into insolvency analysis.[26]

Korobkin[27] suggests that the economic approach is incapable of recognising non-economic values such as moral, political, social and personal considerations following failure. He suggests that the creditors' bargain perspective has misidentified the distinct function of corporate insolvency law because it views the law as a response to the economic problem of collecting debt. He contends that insolvency policy should not be 'closed' as the proponents of the creditors' bargain perspective suggest.[28] He concludes that corporate insolvency law must be explained "not as a maximiser of economic

[19] Donald R Korobkin, 'Rehabilitating Value: A Jurisprudence of Bankruptcy' (1991) 91 *Columbia Law Review* 717.
[20] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002).
[21] Rizwaan Jameel Mokal, *Corporate Insolvency Law Theory and Application* (2005) 34.
[22] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review* 775.
[23] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review* 775, 778.
[24] Ibid 788.
[25] Ibid 788 and detailed in fn 25 thereof.
[26] Ibid. 812-813.
[27] Donald R Korobkin, 'Rehabilitating Value: A Jurisprudence of Bankruptcy' (1991) 91 *Columbia Law Review* 717, 762.
[28] Ibid 787-789.

outcomes but as a system for rendering richer, more informed decisions in response to financial distress".[29]

Finch[30] is strident in her criticism of the creditors' bargain model. She posits that, in real life, creditors differ in their knowledge, skill, leverage and their ability to bear the costs of litigating so that such a perspective is wrong in the way it assumes creditors to be de-historicised and equal.[31] This argument suggests that not all stakeholders are suited by a creditors' bargain perspective. The stakeholders differ in knowledge, skill and leverage bargaining position. For example, employees are unlikely to have the 'knowledge' to bargain and achieve an advantageous position upon the insolvency of their corporate employer. Moreover, the skill and position of a liquidator to arrange the payment of their own fees and reimbursements is clearly superior to other priority creditors. A deserving creditor like a consumer who makes a prepayment to a corporation who later fails is clearly in a poor position to leverage a special bargain should insolvency occur to their supplier. Also, the costs of litigating to obtain improve a position against other creditors again suggests some priority creditors would not benefit from an insolvency law based upon a creditor's bargain. For example, the ability to keep litigation costs down as happens with the governments employing its own legal staff as opposed to very small business creditors who need to fund the litigation personally, suggests that the function of insolvency law should be somewhat broader than merely maximising the collective returns of creditors as a creditors' bargain model decrees.

Finch continues her rebuttal of the creditors' bargain by questioning the assumption that all creditors have purely economic interests.[32] She cites the employee creditors who face displacement costs and may consider that they have claims on the corporation's assets that are morally superior to those of secured creditors.[33]

[29] Ibid. 789.

[30] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) 28-33.

[31] Ibid. 31.

[32] Ibid.

[33] Ibid.

The creditors' bargain perspective provides for pre-insolvency rights being enforced post-insolvency. However, the insolvency of a company brings into play new factors, for example, the importance of creditors and the making of new decisions about where losses will fall. The insolvency regime that will apply in a particular corporation generally depends upon the course of action taken by the creditors. For a receivership it will be the secured creditor that chooses the insolvent corporations future but for a corporate rescue under Australia's voluntary administration laws or the compulsory winding up of the insolvent corporation, all of the creditors are invited to participate. Insolvency law looks beyond the pre-insolvency rights and recognises formal rights which were not in place before insolvency. Finch goes even further to suggest that while some creditors who suffer in an insolvency and they have formal rights, those without formal rights may also be prejudiced.[34] She nominates employees who lose their jobs and also cites suppliers who will lose customers, the tax authorities whose prospective entitlements might be diminished as those without formal rights who suffer prejudice.[35]

Finch argues that the creditor wealth maximisation 'vision' that the creditors' bargain model emits fails to consider "those who suffer the greatest hardships in the context of financial distress".[36] She criticizes insolvency law being seen in such a narrow construct that it is, in essence, merely a sale of assets for the benefit of creditors, akin to a 'car-boot sale'.[37] Such criticism is justified when one interprets 'creditor' beyond those identified pre-insolvency and contemplates the wider effects of insolvency. The creditors' bargain model cannot therefore support the legislative intervention that addresses the financial needs of priority creditors. Such insolvency legislation to provide a statutory priority for say employees' wages upon insolvency of their corporate employer is clearly not grounded in a creditors' bargain perspective.

In a final blow to the creditors' bargain model, Finch attacks the Jackson idea of pre-insolvency legal rights being carried through to insolvent companies. She states "the

[34] Ibid. 32.

[35] Ibid.

[36] Ibid. 32. This is a point made by Donald R Korobkin, 'Contractarianism and the Normative Foundations', (1993) 71 *Texas Law Review* 541, 581.

argument that insolvency law should only give effect to these pre-insolvency rights can be countered by asserting that a core and proper function of insolvency law is to pursue different distributional objectives than are implied in the body of pre-insolvency rights".[38] This is what eventuates when we have statutory priorities. 'Different' because some creditors are identified for special treatment that they did not receive pre-insolvency. Finch elegantly describes this as "insolvency law's application to the turbulence of financial crisis, as distinct from the calm waters that mark pre-insolvency contracts".[39] The statutory priority treatment represents "an intrusion of a number of value judgements concerning relative priorities of various liabilities and the order in which groups of liabilities should be discharged".[40] These value judgements are not needed before the company's insolvency nor in some cases could they have been made earlier. For example, the financial decision by a company on whether to expend money on environmental cleanup or pay employee redundancies is unlikely to be troublesome and value laden for a solvent company but it can be for an insolvent company.

The creditors' bargain model can only be measured in monetary amounts and seen only through the eyes of the creditor.[41] Recently, Mokal, a supporter of the creditors' bargain model in the past[42] has attempted to apply it to a feature of insolvency law, the automatic stay.[43] He argues the model fails as it has neither descriptive nor moral force.[44] He concludes that the model relies on nothing but creditors' preferences and it suggests no reason why those preferences ought to be considered binding.[45] The creditors, if actually asked *ex ante* to choose an insolvency regime, would, in Mokal's opinion, not be able to reach agreement or would pick a system designed to reflect their pre-insolvency advantages.[46] Any agreement made under the circumstances of the creditors' bargain model would likely be exploitative and oppressive of weaker parties and would have no

[37] Ibid. 29.
[38] Ibid. 32.
[39] Ibid. 32.
[40] Ibid. 33.
[41] Karen Gross, *Failure and Forgiveness* (1997) 138.
[42] Rizwaan Jameel Mokal, *Corporate Insolvency Law Theory and Application* (2005) 34.
[43] Ibid 32-59.
[44] Ibid 59.
[45] Ibid.
[46] Ibid.

justificatory force.[47] The advantage of corporate social responsibility as a persuasive framework is that it would attempt to prevent such outcomes.

Another criticism is that the creditors' bargain model fails to recognize the significant differences among creditors and that not all creditors reach their predicament in the same fashion nor will emerge equally able to withstand the loss caused by the insolvent company's inability to pay. Certainly, some creditors are significantly different from other creditors [such as the financial creditors] and so an expectation upon external administrators to consider the stakeholders in a corporate social responsibility framework is fairer.

4. The Australian position for creditors' bargain

While Australian literature discusses the aims and objects of corporate insolvency law (and these are broadly similar in all Western legal systems),[48] it remains thin on persuasive support for a creditors bargain model or any other vision. Routedge[49] in 1998 tested Australia's voluntary administration law and found it complied both in construction and judicial interpretation with the creditors bargain model. Anderson[50] in 2001 also considered the creditors bargain model when discussing the same voluntary administration law.

Observers of Australian theoretical perspectives on corporate law are advised to be 'wary of pigeon-holing' ideas under any of the perspectives as none can claim to supply an

[47] Ibid.

[48] Roman Tomasic, *Australian Corporate Insolvency Law* (1993) chapter 1 discusses 10 objectives identified by the Australian Law Reform Commission, *General Insolvency Inquiry* Report No 45 (1988) para 33 and Roy M Goode, *Principles of Corporate Insolvency Law* (1990) 5-9. Many other writers call upon these objectives to introduce their insolvency discussions.

[49] James Routedge, 'Part 5.3A of the Corporations Law (Voluntary Administration): Creditors' Bargain or Creditors' Dilemma' (1998) 6 *Insolvency Law Journal* 127.

[50] Colin Anderson, 'Commencement of the Part 5.3A Procedure: Some Considerations from an Economic and Law Perspective' (2001) 9 *Insolvency Law Journal* 4. This author also notes a "substantial attempt to look at some of the economic issues surrounding the insolvency legislation in Australia in a Staff Research paper issued through the Productivity Commission. See Bickerdyke, Lattimore and Madge, *Business Failure and Change: An Australian Perspective* , Productivity Commission Staff Research Paper (AusInfo, Canberra, December, 2000)".

overarching explanation of the solvent or insolvent corporation.[51] Theoretical imprecision still exists in Australia and elsewhere and much of this area of law operates according to simple pragmatic influences.[52] Historically, there is evidence to suggest that insolvency law developed without much thought for theories or visions. Lester, writing about the Victorian era, suggests that this area of law "originated from the need to solve the practical commercial problem created by failed businesses. Its roots were not in political philosophy or a particular theory of government, and there appears to be no evidence that it ever became a partisan political issue".[53]

5. The communitarian perspective

In response to the shareholder primacy perspective in corporate law other perspectives have been presented. One of these is communitarianism.[54] This perspective regards corporations as being comprised of important constituencies in addition to shareholders. In this manner it has a strong relationship to the understanding of corporate social responsibility. The list of constituencies is long and includes corporate employees, secured and unsecured creditors, customers or clients, and the local communities in which a corporation operates.[55] There is no complete list and communitarians can disagree about which non-shareholder constituencies are included.[56] What communitarians want is the corporation to be responsive to all constituencies.[57]

Communitarians view individuals as being connected to each other and as being 'obliged' to act in the interests of the good of the community even if that curtails some individual

[51] Roman Tomasic, Stephen Bottomley & Rob McQueen, *Corporations Law in Australia 2nd ed*, (2002) 66.
[52] Ibid.
[53] V Markham Lester, *Victorian Insolvency* (1995) 37.
[54] See, eg., David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law' (1993) 50 *Washington & Lee Law Review* 1373, 1379; Daniel J Morrissey, 'Toward a New/Old Theory of Corporate Social Responsibility' (1989) 40 *Syracuse Law Review* 1005, Lawrence E Mitchell, *Progressive Corporate Law* (1995), .
[55] Roman Tomasic, Stephen Bottomley & Rob McQueen, *Corporations Law in Australia 2nd ed*, (2002) 60.
[56] Larry Mitchell, 'The Fairness Rights of Corporate Bondholders' (1990) 65 *New York University Law Review* 1165.
[57] Michael Bradley, Cindy A Schipani, Anant K Sundaram and James P Walsh, 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law & Contemporary Problems* 9, 45.

freedom.[58] The communitarian perspective recognises that legal persons are not all separate 'individuals' but part of an interconnected world.[59] When considering to whom the company owes a duty (rather than the company operating purely for the profit of shareholders) there is an argument that directors should take the interests of the community into account. There would then be no distinction between the interest of the shareholders, seen as private, with the interests of the community, that is, the public.[60]

Where shareholder primacy uses law as a means of ensuring *ex ante* freedom and efficiency of contracting, communitarians see law as a vehicle to ensure distributive justice and equity from the payoffs to contracts.[61] As Bradley et al recognise the communitarian view argues for various types of corporate constituency statutes providing an ability to choose different rules for different situations.[62] Bradley et al conclude the conceptual battle lines between contractarianism and communitarianism are "stark" because the contractarian finds legitimacy in the values of liberty and competition whereas the communitarian emphasizes justice and cooperation.[63]

6. A Communitarian perspective of insolvency that includes corporate social responsibility

In the mid 1990s a radical view was outlined that both the corporate and personal insolvency systems should take into account the interests of the community, basically that insolvency law be interpreted from a communitarian perspective. [64]This alternative view

[58] The definitive work on communitarianism generally (i.e. not in the corporate or insolvency law sense) is Amatai Etzioni, *The Spirit of Community; Rights, Responsibilities and the Communitarian Agenda* (1993) and Amitai Etzioni, *The Moral Dimension: Toward a New Economics* (1988).

[59] Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 *Washington University Law Quarterly* 1031, 1040.

[60] Karen Gross*, Failure and Forgiveness* (1997) 205.

[61] Michael Bradley, Cindy A Schipani, Anant K Sundaram and James P Walsh, 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law & Contemporary Problems* 9, 45.

[62] Michael Bradley, Cindy A Schipani, Anant K Sundaram and James P Walsh, 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law & Contemporary Problems* 9, 45.

[63] Michael Bradley, Cindy A Schipani, Anant K Sundaram and James P Walsh, 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law & Contemporary Problems* 9, 42.

[64] Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 *Washington University Law Quarterly* 1031.

was not so unusual given an environment of a dominant creditors' bargain model that provided a view of insolvency law as a narrow restricted law that merely applied to contractual creditors and the insolvent debtor. In a growing insolvency scholarly environment, North American discussions (and to a lesser extent, British) on alternative and, arguably, more appropriate visions of corporate insolvency have propagated.

The application of communitarian concepts including a corporate social responsibility perspective to the world of insolvency suggests that the welfare of the community should be very much a part of corporate insolvency. A communitarian perspective "mandates attention to what is often ignored in contemporary policy debates: the social side of human nature…the ripple effects and the long term consequences of present decisions".[65]

Communitarianism in insolvency, and by inference therefore corporate social responsibility, defines the scope of corporate and personal bankruptcy as legal regulation beyond the debtor and its immediate creditors. It follows, therefore, that at the heart of the debate about insolvency policy is a determination of who and what the system is designed to protect.[66]

Obviously defining what is meant by 'community' is important to a perspective based upon the premise that the community matters.[67] The present discussion paper in 3.3.2 when describing the pluralist approach and discussing the Steering Group observes that body did not attempt to define precisely the non-shareholder participants. Placing communitarianism into the insolvency context requires some thought about the identifiable players in the system, followed by looking beyond these players to identify, if possible, others affected by insolvency, whose interests should be considered.

[65] Ibid. 1042 where she is footnoting Amatai Etzioni, *The Spirit of Community; Rights, Responsibilities and the Communitarian Agenda* (1993) 253-254.

[66] Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 *Washington University Law Quarterly* 1031, 1046.

[67] Barry S Schermer, 'Response to Professor Gross: Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 *Washington University Law Quarterly.*1049, 1051.

The community in insolvency must, by its definition, involve the debtor and creditor.[68] Traditionally, insolvency has also involved a third party assigned to wind up the estate. This liquidator or trustee has had an independent role to assist in the efficient management of the insolvent estate. The courts, perhaps a 'fourth party', have had a long involvement in insolvency[69], including the appointment of liquidators and the source of support and direction for third parties such as liquidators. The government has been a long-term member of the insolvency community, arguably a 'fifth party'. Governments have been involved not just in the making of laws but also in areas such as conducting the licensing of liquidators, and qualifying as an involuntary creditor for taxes and other government debts. The government continues as a source of administrative help in such areas as the present Australian employees' entitlement support scheme (General Employee Entitlements & Redundancy Scheme) which is designed to protect employees wages. Others that will make up the community in insolvency are less identifiable members such as involuntary creditors like tort victims.[70]

7. Support for a communitarian perspective from the Law Reform Commissions

The influential Cork Report[71] (United Kingdom) in 1982 refers to the law of insolvency as embodying a "compact to which there are three parties: the debtor, his creditor and society".[72] Any system which is to cope with the consequences of an insolvency has to bear in mind the interests of these three parties.[73] Each of the principles (or aims) of insolvency as outlined by the Cork Report[74] could fit into this perspective. In what could be taken as support for the communitarian perspective, the Cork Report stated:

> "We believe that a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be

[68] The statutory definition of solvency is an ability to pay debts as and when they are due and payable. section 95A of the *Corporations Act 2001* (Cth).
[69] In the New South Wales colony the courts heard insolvency matters from 1823 onwards.
[70] One recent Australian example, involving the James Hardie companies, has been the potential victims of asbestosis and their future payouts should the company not be present to pay when these claims materialise.
[71] Review Committee, *Insolvency Law and Practice,* Cmnd 8558 (1982) 'the Cork Report'.
[72] Ibid. para 192.
[73] Fiona Tolmie, *Introduction to Corporate and Personal Insolvency Law* (1998) 3.
[74] Review Committee, *Insolvency Law and Practice,* Cmnd *8558* (1982) para 198.

> so disastrous to creditors, employees and the community that it must not be overlooked."[75]

In Australia, the Harmer Report[76] in 1988 stated, in its opening paragraph, that insolvency law concerns not only the principal participants of debtor and their creditors but it has a direct impact on many others.[77] The Harmer Report expressly mentions employees, family, customers and agencies of government such as those concerned with the revenue and administration of the law[78] as the 'others' that insolvency law has a direct impact upon.[79]

In summary, both the United Kingdom and Australian Law Reform Commissions have made ready acknowledgement that the insolvency law is made up of more that just debtors and creditors. Such support for a broader view accords to communitarianism, corporate social responsibility and exceeds the creditors' bargain model.

8. Present support for a broad perspective

Recent discussions on perspectives in corporate insolvency have supported broadening the focus even beyond the creditors' bargain model and narrow versions of communitarianism including corporate social responsibility.[80] Keay[81] has discussed the importance of the public interest in insolvency and Finch[82] has described her 'visions'

[75] Ibid. para 204.

[76] Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988) ('the Harmer Report').

[77] Ibid. para 1.

[78] Ibid.

[79] Ibid. para 33 there is the heading is *Aims of insolvency law* and immediately underneath the heading 'Principles' where nine (9) principles are discussed. None of the principles address perspectives or the community other than in a general way although the Harmer Report notes that "on a more abstract level insolvency law is viewed by some as the guardian of values that seem appropriate in the conduct of the credit economy" (para 33).

[80] It is not suggested that the discussion of theoretical perspectives in insolvency is commonplace. Mokal's book *Corporate Insolvency Law Theory and Application* (2005) follows Finch's *Corporate Insolvency Law Perspectives and Principles* (2002) as two recent English texts dedicated to moving beyond the practical description of insolvency law.

[81] Andrew Keay, 'Insolvency Law: A Matter of Public Interest?' (2002) 51 *Northern Ireland Legal Quarterly* 509.

[82] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) chapter 2.

which include creditors' bargain and communitarianism but also to three other 'benchmarks'; forum vision, ethical vision and a multiple values/eclectic approach.

The concept of the public interest definition, when considered in the insolvency context, has an admirable width. Scholars have defined 'public interest' by default as the interest of those other than the debtor. Keay suggests it is the interests of anyone who has a stake, financial or otherwise, in the business of the insolvent company.[83] This is supported by Gross' community approach where she includes many as having a community interest, a term that Keay suggests can equate to public interest.[84] Keay concludes that, rather than formulating a conclusive definition, the legal system should interpret the public interest as "taking into account interests of those parties involved in any given insolvency situation".[85] However he then appears to limit his interpretation of the insolvency system to the debtor and the creditors.[86] Certainly insolvency law as part of a legal system appears to take into account the interests of some parties that consider they deserve statutory priorities, and meets their needs. Other parties that do not enjoy a statutory priority can argue that it is in the 'public interest' that insolvency law extends further to embrace their position.

Insolvency is generally categorised as a matter of private law because of the private nature of the rights of creditors against particular debtors and the amounts those creditors will receive by way of payment.[87] Keay argues that "insolvency law is wider than that".[88] No legal issue can be seen as 'off limits' to a consideration of the public interest[89] and insolvency law has the potential to involve substantial numbers of the public suggesting that the public interest should be considered. Such a concept as the public interest is certainly a consideration for the formulation of statutory priorities. The legislators have had to consider whether the modifications to the principle of *pari passu* is appropriate. In

[83] Andrew Keay, 'Insolvency Law: A Matter of Public Interest?' (2002) 51 *Northern Ireland Legal Quarterly* 509.
[84] Andrew Keay, 'Insolvency Law: A Matter of Public Interest?' (2002) 51 *Northern Ireland Legal Quarterly* 509, 524.
[85] Ibid.
[86] Ibid. 525.
[87] Ibid. 509.
[88] Ibid. 510.

doing this, serious social issues, such as employees going without their wages due to the insolvency of their corporate employer, are bound to be seen a matter of public interest.

Keay asserts that parliaments, law reform commissions and the courts do take the public interest into account when considering significant insolvency law issues.[90] There has been a steadily expanding range of interests considered in the history of corporate insolvency law. Keay concludes that unless the public interest is considered, it is likely that rudimentary elements of our society will be damaged and the law will be regarded with contempt and as something which is aloof from everyday life.[91]

Finch[92] acknowledges that an important aspect of communitarianism is the centrality that is given to distributional concerns.[93] For her, the problem is not that community interests cannot be identified but that there are so many potential interests in every insolvency and, so, the selection of interests worthy of legal protection or for special treatment like a statutory priority is liable to give rise to considerable contention.[94]

In an attempt at pushing the contemplation of perspectives beyond the creditors' bargain model, Finch describes a vision of the insolvency process establishing a 'forum' in which all interests, not just monetary, that are affected by business failure would be recognised.[95] This would shift the focus beyond creditors to all participants in the company's financial distress. While underdeveloped at this point in time it has been described as requiring the law to establish 'space' and should provide "not just interested parties" with a "medium of …discourse".[96] Another 'vision' recognised (and questioned) by Finch is the ethical one[97] promoted by Shuchman.[98] This perspective does not broaden

[89] Ibid.
[90] Ibid.
[91] Ibid. 534.
[92] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) 25-56.
[93] Ibid. 36.
[94] Ibid. 37.
[95] Ibid. 38.
[96] See, eg, A Flessner, 'Philosophies of Business Bankruptcy Law: An International Overview' in Jacob S Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (1994)and D R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 *Columbia Law Review* 717.
[97] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) 39.

the amount of members or actors but proposes that the foundations of insolvency law take into account the situation of the debtor, the moral worthiness of the debt, and the size, situation and intent of the creditor.[99] Finally, Finch recognizes a notion that insolvency law serves a series of values.[100] This 'vision' encapsulates economic and non-economic dimensions and the principle of fairness as a moral, political, personal and social value.[101] Found predominantly in the work of Warren[102] and Korobkin,[103] the multiple value/eclectic approach attempts to achieve such ends as distributing the consequences of financial failure amongst a wide range of actors and protecting the investing public, jobs, and the public and community interests.[104] This approach is recognised by Finch as broad enough to incorporate communitarian philosophies and the forum vision.[105]

Both Keay and Finch from the above discussion make a conjecture to move the theoretical perspective of insolvency law beyond the creditors' bargain model. As for statutory priorities there has bee no 'microscope' study of the appropriate perspective. Finch has suggested that while there is silence on which perspective is used for distributional matters in insolvency, such matters are too serious a matter to be overlooked by those concerned with fairness and justice.[106] She concludes that valuing factors other than economic efficiency as the creditors' bargain model does is an important step to analysing and justifying distributional fairness.[107]

9. The future for the broader perspective of the progressives

The theoretical perspective that could emerge as the vision to be applied to corporate insolvency law, certainly as a portion of distributional fairness, may embrace a communitarian's fairness and justice. Meanwhile corporate social responsibility

[98] Philip Shuchman, 'An Attempt at a Philosophy of Bankruptcy' (1973) 21 *University of California Los Angeles Law Review* 403.

[99] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) 39.

[100] Ibid. 40.

[101] Ibid.

[102] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review* 775.

[103] D R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 *Columbia Law Review* 717.

[104] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principle*, (2002) 40-41.

[105] Ibid. 41.

[106] Ibid. 53.

[107] Ibid. 55.

approaches or any other broad approach must continue to support established insolvency principles[108] like the aim to "realise the assets of the insolvent which should be properly be taken to satisfy debts with the minimum of delay and expense", or the aim to "distribute the proceeds of realisations amongst creditors fairly and equitably. Another aim is "to recognise and safeguard the interests not merely of insolvents and their creditors but those of society and other groups in society who are affected by the insolvency, for instance not only the interests of directors, shareholders and employees but also those of suppliers whose livelihoods depend on the enterprise and the community".[109] As such an aim already exists it may serve to provide the base from which wider theoretical perspectives like corporate social responsibility will develop.

10. Specific responses to the discussion paper

Some parts of the discussion paper can be contemplated in light of corporate insolvency. In 1.3.2 the discussion of philanthropic approach is necessarily irrelevant to the liquidator who may take on some directors' functions but would almost never be in the position of contemplating philanthropic actions which would work against the interests of creditors.
In 1.3.3 the commercial approach has the focus on the long term interests of the company and again this has little relevance for the insolvent company and its external administrator. The attracting and maintaining employees or brand image or identifying new business opportunities are generally not high on the liquidator's priorities.
In 1.3.4 the ethics-based approach has some relevance to external administrators. In particular it may influence who they can sell company assets.
In 1.3.5 the altruistic approach that contemplates solving social problems is not one that resonates with the insolvent company and possibly quite the opposite, the insolvency will cause social problems, is generated.
In 1.4 stakeholders, sustainability and triple bottom line reporting could be approached with the contemplation of the insolvent company. While the directors may make these

[108] These principles are found in Report of the Review Committee on Insolvency Law and Practice (Cmmd 8558, 1982) para 198, Roy M Goode, *Principles of Corporate Insolvency Law* (1990) 5-9, Roman Tomasic, *Australian Corporate Insolvency Law* (1993) 4-12.

[109] Report of the Review Committee on Insolvency Law and Practice (Cmmd 8558, 1982) para 198(i)

commercial judgments to determine what stakeholder interests should be considered in the solvent company, the task would pass to the external administrator in an insolvent company. The decision though in the insolvent company is really one for the creditors.

In 2.1 the division of the corporation is discussed particularly the influence of the shareholders in general meeting but in the insolvent company it will be the creditors at their creditors meetings that could adopt various environmental or social policies or goals. This has been a possibility in more recent times with unions playing a very important role at creditors' meetings. One example was the Ansett voluntary administration.

In 2.6 the ASX principles are discussed and the recommended listed company code of conduct is one example that could be copied for external administrators so that they would be required to present to creditors and stakeholders the so called 'community factors'.

In 3.4 the questions are asked should directors be permitted or required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. For corporate insolvent law and practice the question becomes "should liquidators/administrators/controllers be permitted or required to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. My submission is that they should be required to take this broader communitarian or corporate social responsibility perspective.

In 4.5.2 the quote from EU Commission give reasons why environmental issues should be disclosed. The reasons are for investors and for regulatory authorities. In the insolvent company the disclosure of such information is required for the external administrator, the creditors and for the many other stakeholders.

In 4.5.3 the discussion of an OFR and its purpose points to other stakeholders having some interest in its preparation. Should a similar review be available in Australia the process of addressing the second creditors meeting in Part 5.3A may well be assisted. In fact in most external administrations the contents of an OFR would assist. Perhaps it is time to relook at the extent of coverage of s299A CA.

As a final comment I would strongly support the initiative of "funding appropriate empirical and other research" as I feel other common law countries seem to be ahead of Australia in directing research into company law and its subsets like corporate insolvency law.

11 Conclusion

The literature and scholarship on Australian corporate insolvency law is in its infancy when discussing theoretical perspectives such as corporate social responsibility. The closest expressed perspective has occurred in the 'aims' paragraph of the Harmer Report[110] and the text by Tomasic[111] where the authors use objectives earlier identified by Goode[112] in the United Kingdom. Corporate insolvency principles usually include fairness, expedition, efficiency and impartiality. Such principles are often incorporated into these expressed aims or objectives. Discussion on the principles of insolvency law like the principle of equal sharing between creditors and orderly processing of insolvencies can be made in the context of corporate social responsibility.

When observing international perspectives on insolvency and local and international perspectives on corporate law, it is acknowledged that the creditors' bargain vision is dominant, although regularly criticised. This submission expresses the need for a broader approach and encourages the development of corporate social responsibility in both corporate law but more specifically raises it in the corporate insolvency context. I suggest we engage in further enlightened discussion and we could potentially lead the world in developing a corporate social responsibility approach not just for corporate law but for corporate insolvency law as well. Many submissions will call for the status quo to be

[110] Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988) para 33. ('the Harmer Report').
[111] Roman Tomasic, *Australian Corporate Insolvency Law* (1993) 4-12.
[112] Roy M Goode, *Principles of Corporate Insolvency Law* (1990) 5-9, 54-63.

maintained. This is to be expected from the conservative dominance in corporate practice and the slavish acceptance of shareholder primacy. Perspectives like corporate social responsibility were not taught in the Universities when the commercial practice world were students and so many have not been exposed to such ‘progressive’ thought when it comes to theoretical perspectives of the corporation. It is now time to facilitate a re-think.

Christopher F Symes
Senior Lecturer in Corporate Law
Flinders University
Adelaide SA

Corporate Social Responsibility

February 2006

James Hardie Special Commission of Inquiry

Early in 2004 the NSW Government established a Special Commission of Inquiry to examine the circumstances surrounding the establishment of the Medical Research and Compensation Foundation by the James Hardie group of companies.

The circumstances considered by the James Hardie Special Commission of Inquiry highlighted the fact that some Australian directors believe that they are required to act solely in the interests of their shareholders.

The findings of the James Hardie Special Commission of Inquiry, and the circumstances surrounding the Inquiry, are extremely important to the NSW Government. The NSW Government would like to ensure that these circumstances do not arise again in the future. We are eager to ensure that all necessary amendments to the *Corporations Act* 2001, arising out of the Inquiry's final report, are progressed as quickly as possible.

The James Hardie experience illustrates that reform is required

James Hardie's directors claimed, at least initially, that they were unable to contribute funds to meet the liabilities of their former subsidiaries because of their duties to their shareholders. It was submitted that using company profits to compensate asbestos victims could have exposed the directors of James Hardie to a class action by its shareholders.

Directors' duties must be clear. Company directors, in controlling the actions of the company, must not make their decisions in a vacuum, motivated solely by profit. The community expects that company directors will consider the public interest in making their decisions. The law must clearly state that directors are able to do this.

It may be that the James Hardie interpretation of directors' duties provisions was not supported by the law. The Australian Institute of Company Directors (AICD), as well as the Business Council of Australia, rejected James Hardie's argument that their directors would have breached their duties to shareholders by authorising compensation of the asbestos victims.

However it is concerning that such a misinterpretation of directors' duties was made by officers of an ASX top 200 company. The fact that such a misinterpretation was made is especially concerning considering the efforts organisations such as the AICD and the ASX have made to promote the law and good corporate governance.

Reform of Australian law is necessary to clarify that the James Hardie interpretation of directors' duties is not the current law. Some directors may still adhere to the interpretation adopted by James Hardie. The fact that directors are not bound to act solely in the interests of shareholders must be placed beyond all doubt.

Reform must involve legislative change

The AICD has observed that many listed companies now have codes of conduct which recognise, "that to act in the best interest of the company, they must take into account the interests of other stakeholders, including employees, customers, the environment and communities affected by the company's activities." [1]

Over the course of this Inquiry CAMAC may receive submissions which suggest that legislative reform is not required, that voluntary initiatives to enhance corporate social responsibility in Australia would sufficiently address this issue.

However, the circumstances which were considered by the James Hardie Special Commission of Inquiry provide clear evidence that codes of conduct and other voluntary initiatives would not ensure that the appropriate standards of corporate social responsibility are adhered to by all directors.

I believe that prudent directors already consider broader interests in performing their duties. I do not suggest that we need legislative reforms to change the behaviour of prudent directors. However reform is necessary to compel directors, who may not always follow prudent practices, to adhere to appropriate standards of corporate social responsibility. Voluntary reforms or directors' education initiatives may be effective in enhancing the behaviour of prudent directors, but they will not be effective in regulating all directors. Legislative reform is required.

Options for legislative reform

A number of suggestions for legislative reform have been raised with me on an informal basis.

These suggestions include reforms to clarify that:

- directors are able to consider broader interests;
- directors are able to, and in some circumstances would be remiss if they did not, consider broader interests; or
- while directors have a primary duty to act in the best interests of shareholders, in order to properly fulfil their duty to shareholders, directors should have regard to matters of public interest and the concerns of stakeholders.

Rather than imposing new duties on directors who currently perform their duties with due regard for the public interest, amendments to the Corporations Act could simply codify the existing practice of prudent company directors. Amendments

[1] AICD, Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility, 30 September 2005, at p.7.

need not substantively change the existing law. However, amendments should create a greater focus on corporate social responsibility in corporate decision making.

These broader interests, that directors could be required or permitted to consider, may include matters such as the company and its officers acting legally and ethically. It could involve the company ensuring that the legitimate expectations of its employees are considered. It could also involve the company minimising the negative impact, and maximising the positive impact, of the company's operations on the community, on minority groups and on the environment.

Whilst I remain open minded about the precise form that the amendments to directors' duties should take, I am convinced that reform is required and that this reform should be guided by some established, underlying issues.

These underlying issues include the need to remove incentives for directors to act solely in the interests of shareholders. They include the need to clarify that directors' sole motivation must not be the maximisation of profit for shareholders at the expense of the interests of the community. It must be clear that directors will fail in their duty to the company if they do not take relevant stakeholder interests into account.

As I have mentioned above, I am yet to be convinced on the precise formulation of directors' duties that is appropriate for introduction in Australia. However the circumstances considered by the James Hardie Special Commission of Inquiry make it clear that reform is necessary and that that reform must be directed towards a number of underlying issues, issues which have been highlighted by the James Hardie Inquiry. The recommendations that CAMAC must reach need to address these underlying issues.

amnesty international australia

Submission to the

The Corporations and Markets Advisory Committee

regarding

DIRECTOR'S DUTIES & CORPORATE SOCIAL RESPONSIBILITY

March 2006

Submitted by

Amnesty International Australia

PO Box 1708
Canberra ACT 2608

Phone: Rebecca Smith (02) 6202 7503
Fax: (02) 6257 7588

The global defender of human rights

1. Executive Summary

Amnesty International Australia submits that recognition of and support for basic human rights is integral to achieving corporate social responsibility (CSR). We believe the standards identified in international human rights law provide a useful point of reference in clarifying the responsibilities of company directors by defining what society can reasonably expect of them.

There is a need for great consistency in the definition and application of CSR. Amnesty International Australia believes the most effective way to ensure consistent standards for corporations in a global economy is to refer to the universal standards already negotiated by governments that form international human rights law.

We submit that companies which meet the human rights standards identified in this paper will in so doing go a long way towards delivering CSR and meeting the expectations that society has of business.

In answer to the specific questions posed in the terms of reference, we submit the following.

1. *Should the Corporations Act be revised 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?*

Yes. A subsection in or around s181 should clarify that considerations other than profit maximisation are legitimate under the existing directors' duty.

2. *Should the Corporations Act be revised to* ***require*** *directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

Yes. A new duty to ensure the protection of human rights within a corporation's sphere of activity and influence should be inserted. There should be no reference to specific classes of stakeholders.

3. *Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?*

Yes. The adoption of a new directors' duty will go a long way towards that end. Voluntary initiatives and public reporting of social and environmental performance over and above legal requirements should be encouraged.

4. *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*

Yes. Compliance with the duty to ensure the protection of human rights should be covered in corporations' annual reports. Beyond such compliance reporting, triple bottom line reporting should be encouraged but not necessarily mandated for all companies.

Amnesty International Australia's Recommendations to CAMAC

1. New directors' duty

Amnesty International urges the government to reform corporations law to make the protection of human rights central to business decision making. We believe that the most effective way of doing so would be to insert a new directors' duty into the Corporations Act along the following lines:

> *"A director or other officer of a corporation must ensure that human rights are protected within the corporation's sphere of activity and influence."*

The content of the duty should be ascertained by reference to the UN Norms.

2. Reporting obligation

A certification by directors that all relevant human rights issues have been considered and complied with should be required as part of companies' annual reports. A disclosure of any particular human rights risk factors associated with a company's operations should also be required.

3. Enforcement of the duty

Individuals who allege to have suffered human rights violations in the course of a company's operations should be able to initiate proceedings for breach of the directors' duty, either directly or through a designated authority such as ASIC. Confirmed breaches of the duty should give rise to criminal or civil penalties, depending on the nature of the breach, in line with existing penalties in the Corporations Act.

4. Voluntary reporting

Voluntary public reporting on socially responsible business practices should be encouraged and should incorporate reference to established international human rights standards. It should be made clear that such reporting is separate from certification of compliance with a directors' duty to protect human rights and reporting of risk factors.

2. About Amnesty International

Amnesty International is a worldwide movement of more than 1.8 million people across 150 countries working to promote the observance of all human rights enshrined in the Universal Declaration of Human Rights and other international standards. In pursuit of these goals, Amnesty International undertakes research and action focused on preventing grave abuses of human rights including rights to physical and mental integrity, freedom of conscience and expression, and freedom from discrimination.

Amnesty International is independent of any government, political ideology, economic interest or religion. It does not support or oppose any government or political system, nor does it support or oppose the views of the victims whose rights it seeks to protect. It is concerned solely with the impartial protection of human rights.

Amnesty International has been at the forefront of work on the development and fulfilment of human rights standards for over 40 years. In addition to its work on specific abuses of human rights, Amnesty International urges all governments to ratify and implement human rights standards and works to create a human rights culture throughout society.

While Amnesty International is concerned with human rights specifically, CSR as a term covers considerably wider subject matter, particularly environmental impact and performance. In practice, measures aimed at environmental protection often contribute to human rights. However, as an organisation focused on human rights, Amnesty International refrains from commenting on the environmental side of corporate regulation.

Part 1: Incorporating international human rights standards into corporate social responsibility

What's wrong with the current state of Corporate Social Responsibility?

In general terms, corporate social responsibility (CSR) as a concept compels business to look beyond the exclusive focus on profits and take into account, evaluate and take responsibility for the social and environmental impact of their operations. A helpful working definition of CSR is that used by the group Business for Social Responsibility: "Operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business."[1]

A recent global survey of business-people found that more than four out of five respondents agreed that the role of business in society is to generate high investor returns accompanied by contributions to the broader public good.[2] So the notion that companies should operate so as to support, or at least not damage, the broader public good is well accepted. Indeed, many companies are already delivering a commendable standard of corporate behaviour in terms of their effect on the lives of their employees, the environment and the local communities in which they operate. However, some companies are not, often due to the limited "reputation" exposure of their business.[3] As a result,

[1] See http://www.bsr.org/

[2] McKinsey Quarterly, *The McKinsey Global Survey of Business Executives: Business and Society,* Jan 2006, http://www.mckinseyquarterly.com/article_page.aspx?ar=1741&L2=21&L3=114 .

[3] For a summary of the varying levels of "human rights risk" associated with different types of businesses, see Amnesty International's submission to the Joint Committee on Corporations and Financial Services inquiry into corporate responsibility, entitled *Are Human Rights Everyone's Business?*, September 2005, pp 6-10.

human rights violations continue to take place in a context where powerful, well-resourced companies have the ability to do more to prevent them (see Case Study).

At the same time, most previous initiatives to codify and standardise the CSR responsibilities of companies have had limited success. One such example is the OECD's Guidelines for Multinational Enterprises. These are non-binding guidelines which companies are asked to respect wherever they operate. Since they include only a limited and general human rights provision, they offer little guidance on how to resolve human rights issues.

Such guidelines have been valuable in raising awareness of key issues among companies. To date, however, they have failed to allay public mistrust, to ensure accountability for human rights in corporate activities, and most importantly to reduce significantly the negative impact of some companies' activities on human rights. While we continue to support voluntary mechanisms such as the OECD Guidelines and the Voluntary Principles for Security and Human Rights in the extractives sector, we believe that appropriate, limited level of codification of CSR standards within the Corporations Act is desirable for Australian companies and for the broader community.

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From the perspective of business, compliance with standards that are undefined, or have competing definitions and benchmarks, naturally causes significant problems. Furthermore, for those companies that truly are implementing best practice in terms of social responsibility, the absence of a solid and internationally consistent framework denies them the level playing field to use their good conduct as a legitimate competitive advantage in the marketplace.

At the practical level, although CSR is a widely used term there is a lack of consensus on what this specifically means. While there may be some advantages in allowing businesses to tailor their response to CSR to suit their individual circumstances, there are clear disadvantages. Businesses require certainty in the regulatory and legal climate. At the same time, the broader Australian community is seeking greater transparency of corporate operations, and in at least some specific cases, improved corporate behaviour. Codification of CSR in the Corporations Law, accompanied by an appropriate reporting regime, will address the concerns on both sides.

Case study: Royal Dutch Shell and Chevron Corporation in Nigeria

Ten years after the executions of writer and human rights campaigner Ken Saro-Wiwa and eight Ogoni companions in Nigeria, the peoples of the oil-producing Niger Delta continue to face death and devastation at the hands of Nigerian security forces. In 2005, Amnesty International urged oil multinationals Shell and Chevron to investigate their local subsidiaries' involvement in and responsibility for continued human rights abuses by security forces, and to ensure they respect the human rights of the communities where they operate.

Meanwhile, oil spills blacken the land and pollute the waterways, and gas flares take place close to farms and homes. Operational practices such as these would not be tolerated in the countries where major oil companies have their headquarters.

The Niger Delta's marginalised peoples have no effective recourse against human rights abuses, and remain among the most deprived oil communities in the world. Seventy per cent live on less than US$1 a day.

While Amnesty International calls on the Nigerian government to end the impunity enjoyed by the security forces for human rights violations past and present, we also ask multinational oil corporations to operate within the framework of international human rights standards for companies.

Both Shell and Chevron have taken on board the Voluntary Principles for Security and Human Rights for companies in the extractive sector. These principles guide companies in maintaining the safety and security of their operations within a framework that ensures respect for human rights. They apply wherever the company operates but have no monitoring mechanism, making it difficult to evaluate companies' adherence.

Continuing human rights abuses in Nigeria make it clear that a transparent reporting and monitoring regime is needed to deliver on the promise of CSR.[4]

International law and Australia's international human rights obligations are the foundation of CSR

The most effective way to ensure consistent standards for corporations in a global economy is to refer to the universal standards already negotiated by governments that form international human rights law.

Under international law, all states have an obligation to respect, protect and promote human rights within their jurisdiction through, among other things, appropriate legislation and regulation. For example, the International Covenant on Civil and Political Rights, to which Australia is a party, requires states to "adopt such legislative or other measures as may be necessary to give effect to the rights recognized in the present Covenant".[5] Similar obligations are contained in the International Covenant on Economic, Social and Cultural Rights[6] and other international human rights instruments to which Australia is a party.

Australia therefore has an obligation under international law to legislate to ensure that everyone within its jurisdiction, including natural persons, corporations and other entities, respect human rights. For such measures to offer meaningful protection, they must also be backed by enforcement mechanisms to deter human rights violations, punish perpetrators and provide remedies to victims.

Given that corporations are regulated at the domestic level, Australia's undertaking to ensure the protection of human rights in all aspects of life requires domestic legislation addressing corporations to include measures incorporating international human rights standards.

Overseas operations

Legislation to enforce human rights standards on Australian corporations should extend to all their operations, rather than being limited to operations within Australia. Human rights duties on Australian corporations should cover the foreign operations of companies incorporated in Australia, as well as the operations of overseas subsidiaries that are controlled by Australian entities.

The justification for the international reach of such legislation is twofold. First, given that human rights derive not from the gift of the state but by virtue of being human, nationality or geographic location is no justification for affording a lesser level of protection to some people affected by Australian

[4] Source: "*Claiming Rights and Resources - Injustice, Oil and Violence in Nigeria*", *Amnesty International, November 2005.* *http://web.amnesty.org/library/index/engafr440202005*

[5] International Covenant on Civil and Political Rights, 1966, Article 2(2).

[6] International Covenant on Economic, Social and Cultural Rights, 1966, Article 2(1).

enterprises than others. Australia has pledged to the international community to do everything within its power to ensure the realisation of human rights. It should therefore legislate to the full extent of its sovereignty over Australian-based and Australian-controlled commercial operations.

The second justification is more commercial and pragmatic. If Australian enterprises are held to account for the effect of their operations on human rights within Australia, but not in other countries, some may be encouraged to move their more controversial operations offshore. Extending legislation protecting human rights to the foreign operations and foreign subsidiaries of Australian enterprises would remove that avenue as a method of avoiding scrutiny and accountability.

Extraterritorial laws protecting non-Australian victims from harm inflicted by Australians outside of Australian territory is nothing new. The child sex tourism provisions inserted into the Commonwealth Crimes Act in 1994 are a prime example of Australian law punishing harmful behaviour overseas by individuals and corporations with a nexus to Australia.[7]

The content of the human rights standards

The international community already expects corporations, along with every other kind of entity in society, to respect human rights. To guarantee universal human rights to every person, every type of entity – government, individual or corporation – needs to observe human rights. That intention is clear in the Universal Declaration of Human Rights, which calls on "every organ of society" to respect, promote and secure the rights that are set out in that Declaration, setting the context for the various human rights conventions that followed it.

Since corporations are predominantly regulated at the domestic level, international human rights law has historically addressed states in framing the rights that must be observed, leaving states to implement protection of those rights, including in the corporate context, in their own domestic legal systems. As the global operation of corporations has become more pervasive, efforts have been made to reframe those legal obligations in a manner that addresses corporations directly. The United Nations Sub-Commission on the Promotion and Protection of Human Rights has formulated the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises[8] ['UN Norms'] to achieve that objective.

The UN Norms succinctly set out the existing international human rights obligations that are relevant to the operations of corporations. The primary responsibility for the realisation of human rights under the UN Norms remains with the state, but at the same time, corporations have a concurrent duty to respect, protect and promote human rights "within their respective spheres of activity and influence".[9] The UN Norms go on to elaborate human rights duties in such areas as non-discrimination, involvement in war crimes and crimes against humanity, the use of security forces, labour rights and economic, social and cultural rights, as well as issues such as corruption and the environment.

The full text of the UN Norms, including the official commentary, is contained in Amnesty International's document, *The UN Human Rights Norms for Business: Towards Legal Accountability*, which is annexed as an appendix to this submission. The appendix also contains a more detailed

[7] Part IIIA of the Crimes Act 1914 (Cth) contains the child sex tourism provisions. Section 50AD extends the prohibition on proscribed acts overseas to Australian citizens, Australian residents, corporations incorporated in Australia and corporations that are incorporated overseas but carry on their activities principally in Australia. Similar coverage for Australian legislation protecting human rights in the course of commercial activity would be appropriate in Amnesty's submission.

[8] United Nations Sub-Commission on the Promotion and Protection of Human Rights, *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises*, UN document no E/CN.4/Sub.2/2003/12/Rev.2 (2003).

[9] UN Norms, paragraph 1.

explanation of the UN Norms from Amnesty International's perspective and sets out our position on the Norms.

The text of the UN Norms allows for alternative enforcement mechanisms to evolve. Governments are urged to "establish and reinforce the necessary legal and administrative framework" for the protection of the rights set out in the Norms,[10] including by "using them as a model for legislative or administrative provisions".[11]

Amnesty International Australia submits that the UN Norms form the logical reference point for the regulation of corporate behaviour under Australian legislation. Their basis in international law offers the government, the community and corporations themselves a level of consistency and legitimacy not matched by any other CSR model. The limitation of a corporation's obligations to its "sphere of activity and influence" means that corporations are required to carry out their everyday operations in a manner that respects and protects the human rights of those who are touched by their operations.

By incorporating the UN Norms in the scheme of corporate regulation, Australia will meet part of its international obligations to implement the protection of human rights in all aspects of life, including in the course of business. The remainder of this submission addresses the possible mechanisms for implementing the human rights standards set out in the UN Norms, within the scope of the questions posed by the terms of reference to this inquiry.

Part 2: Directors' duties and the protection of human rights

Reform directors' duties to include human rights standards

As noted in Part 1, obligations to respect and protect human rights already exist in international law, and the Australian Government has a duty to implement effective human rights protection in the Australian legal system. In our view, the most effective way of ensuring legal protection of human rights in the course of commercial activity is to oblige those who drive the company and are ultimately accountable for its performance – the directors – to prevent human rights violations in the course of their business.

Various existing Australian laws prohibit many of the activities that would be protected against by a unified duty to protect human rights. Labour law, occupational health and safety regulations, criminal law and other areas all place responsibilities on companies and their directors in terms of their daily operations and the effect they may have on local communities. However, what has emerged over time in these various forms represents a piecemeal approach, lacking consistency, clarity and directness. These failings have led businesspeople such as the Chairwoman of James Hardie Ltd, Ms Meredith Hellicar, to call for the CSR obligations of Australian companies to be clarified. Ms Hellicar in March 2005 called for amendments to corporate law to permit directors to 'integrate corporate social responsibility into their decision making without fear that they are going to be sued'. The simplest and best way to achieve this is by explicitly including human rights protection as a duty of directors in the Corporations Law. It is worth noting, however, that codification of human rights standards would change little in practice for companies whose activities do not present any risk of human rights violations.

[10] UN Norms, paragraph 17.

[11] United Nations Sub-Commission on the Promotion and Protection of Human Rights, *Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises*, UN document no E/CN.4/Sub.2/2003/38/Rev.2 (2003) ['Commentary on UN Norms'], paragraph 17(a).

A directors' duty to ensure human rights would place such concerns as a central issue in business decisions, rather than yet another peripheral compliance issue. Amnesty International Australia believes that incorporating human rights into directors' duties would be the most effective way to encourage companies to adopt socially responsible business practices.

Everyone is a stakeholder in human rights

In relation to the issue of human rights, Amnesty International finds the focus on stakeholders unhelpful. Every human being holds inalienable human rights by virtue simply of being human, and those rights should be respected by everyone, individual, corporation and government alike, regardless of the stake they may hold.

Instead, Amnesty International believes a focus on a duty to protect all the rights of all the people that are relevant in any given circumstance is most appropriate to consider a corporation's responsibilities. We recognise that boundaries of the necessary obligations will change constantly from one situation to another. For these reasons, we prefer to formulate a duty owed to whomever might be affected, without reference to stakeholders. To prevent such a duty from being unreasonably onerous, we propose a link to the actual scope of the corporation's operations through the concept of the "sphere of activity and influence", outlined below.

Clarification of the existing duty to act in the interests of the company as a whole

The primary duty of directors at common law is to act in the best interests of the company as a whole. That duty is also reflected in the duty in s 181(1) of the Corporations Act, which provides:

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

These duties are in addition to numerous other obligations of directors in the Corporations Act and in other legislation, as well as at common law.

The reference to acting in the best interests of the company has generally been interpreted to mean the collective financial interests of the shareholders.[12] The assumption that generally follows that interpretation is that directors are obliged to pursue a course that maximises profit in order to discharge their duty. However, an obligation of profit maximisation has been described as "a common misconception of Anglo-American company law".[13]

It is important to emphasise that non-monetary considerations can serve the interests of the company. Operating in a clean environment, with employees receiving good pay and conditions, and supporting the local community can all serve the best long-term interests of the company, even if a portion of the company's financial resources need to be dedicated towards those goals rather than shareholder dividends.

[12] The CAMAC discussion paper at p 49 provides more background to this issue, including judicial authority.

[13] Janet Dine, *Companies, International Trade and Human Rights*, 2005, Cambridge, Cambridge University Press, p 45. Dine contends that the duty to act in the interests of the company "does not *necessarily* equate shareholders with the company nor does it equate shareholder interests with 'profit maximisation' and impose a duty on directors to achieve such a goal."

While the case law considered in the CAMAC discussion paper indicates that courts will tend to give directors broad scope to determine that such social and environmental endeavours are in the best interests of the company, a clarification in the Corporations Act would benefit the overwhelming majority of business decisions that will never reach the courts. If the opportunity to clarify a common misconception about the content of directors' duties is taken, many businesses may voluntarily devote more of their resources and efforts towards positive social and environmental practices.

Proposed formulation of duty to respect and protect human rights

Amnesty International Australia proposes a new directors' duty to be inserted into the Corporations Act along the following lines:

> *"A director or other officer of a corporation must ensure that human rights are protected within the corporation's sphere of activity and influence."*

Such a formulation draws upon existing international human rights law for the appropriate standards. Of course, directors cannot be expected to determine for themselves what "protection of human rights" entails in their company's operations. Indeed, there is evidence to suggest a significant gap exists between business people and human rights specialists in the interpretation of human rights protection in a business context.[14]

The precise human rights to be protected would need to be set out in clear form in a schedule to the Corporations Act. The elaboration of the rights to be protected would best be served by adapting the UN Norms in a form appropriate for Australian legislation. That document has already undertaken the task of extracting the obligations and practices from international human rights law that are relevant for corporations. More information on Amnesty's position on the UN Norms and the text of the Norms themselves is contained in the appendix to this submission.

The concept of the "sphere of activity and influence" is also drawn from the UN Norms. The intention behind that definition of the scope of a corporation's obligations is to ensure that corporations are not required to go beyond the scope of their own everyday business operations to protect human rights, they are merely expected to carry out their usual business operations in a way that respects human rights.

The concept of "sphere of influence", in relation to complicity with human rights violations, is evolving from company practices, national jurisprudence and the work of international organizations, NGOs and academics. A Special Representative of the UN Secretary-General is currently charged with refining the definition of the "sphere of activity and influence", among other tasks to clarify the practical application of the UN Norms, pursuant to a resolution of the UN Commission on Human Rights on 15 April 2005: E/CN.4/2005/L.87.

The concept is somewhat analogous to the text of what is "reasonable" in a legal sense, taking into account all relevant considerations; the "sphere of activity and influence" of a company depends on its specific circumstances and specific situation. Any attempt to definite it too broadly or narrowly may either imply unreasonable obligations on some or allow others to escape reasonable accountability.

[14] See generally Adam McBeth and Sarah Joseph, 'Same Words, Different Language: Corporate Perceptions of Human Rights Responsibilities', (2006) 11 *Australian Journal of Human Rights* 95-110, reporting on a study by the Castan Centre for Human Rights Law.

For example, the United Kingdom Corporate Responsibility Bill 2003 included the concept of 'reasonable steps'. This bill provides that a director 'shall, when considering any matter or taking any decisions, act in the way which in his opinion would be most likely to promote the success of the company', thus restating an existing and well-understood principle of company law, but qualifies that position by continuing:

> but in so doing, it shall be the duty of the directors of any company—
> (a) to consider—
> (i) the environmental, social and economic impacts of their operations and any proposed operations; and
> (ii) the interests of all their stakeholders
> when making any decision in respect of those operations or proposed operations;
> (b) to take all reasonable steps to minimise any negative environmental, social and economic impacts of any such operations or proposed operations . . .

The concept of 'sphere of influence' is understood by the more than 1,100 companies who have signed the UN Global Compact, which asks companies to "embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption"

At the same time, the "sphere" concept extends beyond the corporate veil that shields separate companies in other circumstances, even when they are engaged in the same enterprise. The sphere of activity and influence[15] would extend to the activities of a supplier, for example, if the corporation exercises control over those activities. If the relationship is independent, the corporation will not be held responsible for the other entity's actions.

Each situation will be different, and this definition of the scope of a corporation's obligations ensures that operational reality rather than legal form is the defining feature.

Enforcement

In order to give meaningful effect to a duty to protect human rights, people who allege that their rights have been violated must be able to initiate proceedings against the relevant directors for breaching the duty. Such a mechanism would be consistent with shareholders' ability to allege breaches of other directors' duties.

An alternative enforcement mechanism which provides a filtering stage for prospective claims could be to direct allegations of human rights violations to a dedicated officer at ASIC, who could then investigate the basis of the complaint and initiate proceedings against the director if the circumstances so warrant.

An intermediate step could also be established for less serious breaches, perhaps involving mediation or discussions between the directors and the alleged victims with a view to improving the protection of human rights in a non-punitive fashion. A model for such a consultative process could be the existing mechanism under the OECD Guidelines for Multinational Enterprises, in which complaints go to the

[15] A Special Representative of the UN Secretary-General is currently charged with refining the definition of the "sphere of activity and influence", among other tasks to clarify the practical application of the UN Norms, pursuant to a resolution of the UN Commission on Human Rights on 15 April 2005: E/CN.4/2005/L.87.

government's designated National Contact Point in each country and a response is sought from the corporation involved, followed by mediation if appropriate.[16]

Confirmed breaches of the duty should give rise to criminal or civil penalties, depending on the nature of the breach, in line with existing penalties in the Corporations Act.

Environmental duties

Specific instances of environmental harm that relate to identifiable human rights violations can be covered by the proposed human rights duties for directors. An example would be the poisoning of a river that people use for drinking water.

This submission has not otherwise considered whether corporations or their directors ought to have environmental duties, given Amnesty's mandate to protect and promote human rights.

Part 3: Reporting

A suitable reporting regime is essential to the success of any effort to codify CSR standards and increase the transparency of corporate behaviour. Codifying human rights standards within corporate law, and creating a genuine reporting and enforcement regime, will avoid many of the pitfalls of other attempts to promote CSR, such as the OECD Guidelines. These efforts have often lacked transparency because companies can endorse the Guidelines without being required to report on their progress in delivering on them.

Corporate reporting on social and environmental performance is gradually becoming mandatory in some countries. For example, France has required triple bottom line reporting for companies listed on the premier marche since 2002, while in South Africa, listing rules for the Johannesburg stock exchange require reporting against the indicators in the Global Reporting Initiative. Australia also requires a form of such reporting from fund managers, who are obliged under the Financial Services Reform Act 2001 to "state the extent to which labour standards, or environmental, social or ethical considerations are taken into account in the selection, retention, or realisation of the investment."

While CSR reporting should be considered a mandatory component of any change to the Corporations Law, this should be incorporated as much as possible into existing reporting arrangements so as to minimise bureaucratic overhead on businesses, Amnesty International Australia believes adequate reporting can comprise two simple parts.

Firstly, directors should as part of regular annual reporting issue a statement of compliance with the proposed change to directors' duties referred to on Page 8.

[16] More information about the dispute process, known as "specific instance" complaints, is available at the website of the Australian National Contact Point: www.ausncp.gov.au.

Example statement of compliance with Human rights legislation

"The directors of XYZ are satisfied that for the financial year YYYY, all relevant human rights issues have been considered and complied with within its sphere of activities and influence. The directors are also satisfied that the disclosure of risk factors below is an accurate and complete list of risk factors in the companies operations as at DD/MM/YYYY"

Such a statement would place an obligation on the company to ensure that this statement is verifiable, including information regarding any factors taken into consideration or not taken into consideration in forming this view.

Secondly, companies should as part of regular annual reporting publish a statement on the level and nature of human rights risks which they face through their corporate activities and sphere of influence. This should use a standardised list of industry types (such as that utilised by the Australian Bureau of Statistics) and geographic areas of operation. As a result of these reports, an estimation of the factors that correlate with actual human rights violations would emerge over time.

The requirement to disclose human rights risk factors and report on the implementation of human rights standards would be analogous to the existing requirement to report on environmental performance under section 299(1)(f) of the Corporations Act.

Example Disclosure of Risk Factors

"XYZ and its contractors are at present involved in extractive industries in the Democratic Republic of the Congo, and as such is rated as a moderate to high risk of potential human rights violations."

Both these statements must be subject to an external audit verification, with remedies for misstatement or non compliance.

Example of Audit Opinion

"Having completed an audit of the human rights impact of XYZ, I am satisfied that the above statements are true and complete."

Or

"Having completed an audit of the Human rights impact of XYZ, we are unable to certify that the above statements are true and complete."

A failure to submit either of the two forms of reporting would initiate action by ASIC under the Corporations Law, whilst audit opinions could be covered under existing audit legislation.

Part 4: Promotion of good corporate citizenship

Amnesty International Australia has argued for changes to the Corporations Law to deliver on the promise of CSR. However, we have also stated our continuing support for voluntary mechanisms and efforts by the business community to self-regulate to deliver to community expectations. We also believe that the Australian Government should invest more in promoting good corporate citizenship.

Since 1999 the Australian Government has taken a strong stand to support initiatives like corporate philanthropy and workplace giving, through the Prime Minister's Community Business Partnership. We believe there is opportunity for the Australian Government to extend the Community Business Partnership into a wider campaign aiming to improve standards of corporate behaviour. A promotional effort to increase understanding of CSR in the business community is required. One existing initiative along these lines is the creation of "*A Guide for Integrating Human Rights into Business Management"*, prepared by the Business Leaders Initiative on Human Rights in Europe. This is currently at the consultation draft stage, and is proposed to be promoted in Europe with support from government when completed.

As there are around 1.2 million small businesses in Australia, we need to assume that at the least any change to company law will need wide dissemination and promotion. But to achieve meaningful change in corporate behaviour, it would be advisable for promotional campaigns to be about much more than just legal changes. To truly deliver CSR, many businesses need to re-think their entire mode of operation, to engage with a much wider group of stakeholders and to consider their activities from a different perspective – that of long-term sustainability.

ASIC
Australian Securities & Investments Commission

MALCOLM RODGERS
Executive Director
Regulation
L18, No. 1 Martin Place, Sydney
GPO Box 9827 Sydney NSW 2001
DX 653 Sydney

Telephone (02) 9911 2000
Facsimile: (02) 9911 2316

Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

CAMAC Corporate Social Responsibility Discussion Paper (November2005) ASIC Submission

The Australian Securities and Investments Commission (ASIC) made a submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into corporate social responsibility (PJC Inquiry). That submission (a copy of which is attached) sets out ASIC's key observations on corporate social responsibility.

However, ASIC would like to comment further on some matters raised in CAMAC's *Corporate Social Responsibility* Discussion Paper (Novembers 2005) (Discussion Paper). These comments are informed by ASIC's experience as an enforcement agency and a regulator of corporate disclosure.

Should the Corporations Act (Act) be revised 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?

As stated in ASIC's submission to the PJC Inquiry, corporations law gives directors considerable freedom to consider the interests of a range of stakeholders, provided the directors' over-riding purpose is to act in the interests of the corporation as a whole. In ASIC's view this aspect of the law is clear and, assuming the Government wishes to retain the current policy settings, the Act does not require amendment.

In particular, ASIC thinks that an amendment based on clause 156 of the Company Law Reform Bill 2005 (UK) may, in fact, create uncertainty. Clause 156 lists a number of matters that directors "must (so far as reasonably practicable) have regard to". Such a list may create uncertainty because directors will, for example, be unsure about:

- the relative weight of matters on the list and, in particular, whether all matters on the list should be given equal weight; and
- whether they can have regard to matters not on the list and whether matters not on the list should be given the same importance as those on the list.

As stated in ASIC's submission to the PJC Inquiry, this sort of uncertainty is of particular concern to ASIC because it is difficult to enforce uncertain legislative provisions.

In general, ASIC considers that the range of matters that may have to be considered by directors are potentially so varied that it would be better to retain the flexibility of the current common law, rather than to force directors to have regard to a list of matters that may be inappropriate for the circumstances of their particular corporation.

Should the Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

The question of whether the law should be amended to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions is a fundamental question of policy. Such a fundamental question of policy is best addressed by the Government, not a regulator such as ASIC.

When addressing that question the Government should be aware that an amendment to directors duties along the lines suggested may affect ASIC's ability to successfully enforce the Act. Depending on its precise nature and drafting, such an amendment may create significant uncertainty. For example, it may be difficult for directors, ASIC and the Courts to:

- identify and define the various classes of stakeholders that might be considered to have a legitimate claim on the attention and resource of corporations; or
- establish an appropriate hierarchy of stakeholders' interests to resolve conflicting stakeholder claims on the attention and resources of corporations.

Such uncertainty would impact on ASIC's ability to enforce the law; the more uncertainty that exists as to the precise nature of a duty and to whom it is owed, the harder it is to prove that the duty has been breached. Where a duty is owed to a number of stakeholders with varying interests, it may be difficult for ASIC to establish that a given action was a breach of the duty, rather than the exercise of a judgment based on perceived merits of competing stakeholder interests.

In light of this, if CAMAC were to recommend that such an amendment be made, ASIC thinks it should be drafted in a way that, to the extent possible, avoids these practical enforcement difficulties. In ASIC's view, it is important that the law contain enforceable duties, rather than vague exhortations to behave responsibly.

Should the Act require certain types of companies to report on the social and environmental impact of their activities?

Again, the question of whether the law should be amended to require some or all companies to report on the social and environmental impact of their activities is a fundamental policy question and should be answered by the Government, not a regulator such as ASIC.

Having said this, ASIC notes that requiring companies to report on the social and environmental impact of their activities is unlikely to negatively affect ASIC's ability to enforce the law. Therefore, from ASIC's point of view, disclosure may be a better regulatory tool, than directors' duties, to shape the environmental, social and economic impact of corporate behaviour.

Disclosure also has other advantages. It is flexible and arms stakeholders with the information they need to form judgments and make decisions that reflect their own interests and values. Various stakeholders will legitimately have different opinions about what corporate conduct is socially responsible and what consequences should flow if corporate conduct is not socially responsible. In this sense, corporate social responsibility is much like corporate governance and matters of ethics. It is best addressed by transparency and in a way that promotes flexibility for individual stakeholders and corporations.

If the Government decides that the law should be amended to require all or certain types of companies to report on the social and environmental impact of their activities, then ASIC considers it is important to ensure that the disclosure is:

- meaningful to shareholders and other stakeholders – this means the disclosure must be concise; lengthy disclosures are unlikely to be read or absorbed by stakeholders. Additionally, it should be easy for stakeholders to compare disclosures by different companies. It is likely that comparability will only be achieved if there are clear guidelines on what should be disclosed,
- accurate and reliable – this may mean that disclosures should be subject to external assurance; and
- cost-effective to produce – the benefit of the disclosure must outweigh the cost of producing it.

If you want to discuss any aspect of this submission, please contact Joanna Bird on (02) 9911 2384.

Yours sincerely

Malcolm Rodgers
Executive Director, Regulation
16 March 2006

ASIC

Australian Securities & Investments Commission

MALCOLM RODGERS

Executive Director

Regulation

L18, No. 1 Martin Place, Sydney
GPO Box 9827 Sydney NSW 2001
DX 653 Sydney

Telephone (02) 9911 2000

Facsimile: (02) 9911 2316

ASIC Australian Securities & Investments Commission National Office, Sydney No. 1 Martin Place, Sydney GPO Box 4866 Sydney NSW 1042 DX 653 Sydney Telephone (02) 9911 2000 Facsimile: (02) 9911 2316 Malcolm Rodgers Executive Director, Regulation

29 September 2005

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Sir,

Inquiry into Corporate Social Responsibility

The Australian Securities and Investments Commission (ASIC) welcomes the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into corporate social responsibility and appreciates the opportunity to contribute to the inquiry.

ASIC would like to make brief observations relevant to issues (c) and (d) of the Inquiry's terms of reference, that is:

- the degree to which the current legal framework permits directors to have regard to the interests of stakeholders, other than shareholders, and the broader community; and
- whether revision to the legal framework are required to enable or encourage companies or their directors to have regard to the interests of stakeholders, other than shareholders, and the broader community.

The Current Legal Framework

Australian corporations laws (that is, the *Corporations Act 2001* and relevant common law principles) do not prevent corporate officers from taking into account the interests of stakeholders other than shareholders. Corporate officers are entitled to take into account the interests of a wide group of stakeholders, provided that there is some benefit
to the company from doing so. (In this context, the company means the shareholders and, in certain circumstances, the creditors.)

Additionally, ASIC notes that laws other than corporations laws often require corporate officers to consider the interests of stakeholders other than shareholders (and creditors). For example, occupational health and safety legislation, consumer protection legislation and environmental protection legislation, require corporate officers to consider the interests of a range of important stakeholders in their decision-making.

Some Reform Implications

ASIC foresees potential practical difficulties were the Parliament to amend the *Corporations Act 2001* so that corporate officers were obliged, or explicitly encouraged, to take a wide range of stakeholders' interests into account. Depending on the precise nature and drafting of any such reform these practical difficulties might include:

- Difficulties in identifying and defining the various classes of stakeholders that might be considered to have a legitimate claim on the attention and resources of companies.
- Difficulties in establishing an appropriate hierarchy of stakeholders' interests to resolve conflicting stakeholder claims on the attention and resources of companies.

These potential difficulties would impact on ASIC's ability to successfully enforce the amended provisions. The more uncertainty that exists as to the precise nature of a duty and to whom it is owed, the harder it will be for ASIC to prove, to the requisite standard, that the duty has been breached. Where a duty is owed to a number of stakeholders with varying interests, it will be challenging to establish that a given action was a breach of the duty rather than the exercise of a difficult judgment based on the perceived merits of competing stakeholder interests.

The issues raised in this submission should not be taken as endorsement of the status quo. We raise these matters because we believe that it is important to consider the implications of revising the current framework regarding corporate officers' rights and obligations to pay regard to various stakeholders in their decision-making.

Thank you for the opportunity to make this submission.

Yours sincerely
Malcolm Rodgers
Executive Director, Regulation

CPA Australia

Submission to

Corporations and Markets Advisory Committee

Discussion Paper

Corporate Social Responsibility

March 2006

EXECUTIVE SUMMARY

CPA Australia believes that it is important to draw a distinction between the legal responsibilities of company directors, their interaction with company stakeholders, and the concept of corporate social responsibility, and that moreover, there is sufficient scope within the law as it currently exists to allow directors to consider stakeholders other than shareholders and it is increasingly common for companies to do so.

The strict notion that companies operate purely in pursuit of profit maximization is a misnomer in both the practicality of modern business, and the legal framework, which affords decision-makers a realistic capacity to make positive allowance for the interests of stakeholders. Directors are obliged to act in the bona-fide interests of the company, however this does not necessarily mean they must always pursue profit maximisation or that they cannot consider the needs of other stakeholders.

The directors' duty is to the ongoing health of the company and must include consideration of the needs of employees, consumers and other stakeholders. Any strategy directed purely at profit maximisation will be realistically tempered by a need to ensure the ongoing viability of the company. On the other hand there needs to be fostered a greater awareness of how changing community expectations can be accommodated within the current framework of directors duties, though without derogating against the essential commercial focus of limited liability.

The introduction of a formalised duty to external stakeholders will upset the cohesion within the evolving structure of the corporations law, create uncertainty and potentially promote undue risk aversion. Directors' primary responsibility must be to the ongoing success of the business and a legitimate component of fulfilling this obligation is to consider all relevant stakeholder interests.

CPA Australia is of the view that some subtle reforms of the Corporations Act are sufficient to address current community concerns – this may occur with respect to both directors' duties and member remedies. Efforts to encourage or prohibit specific social or environmental practices should be addressed through relevant legislation including environmental and labour laws. The corporations law already imposes an obligation on companies to comply with any extraneous laws and this interaction has already compelled improved standards of conduct in environmental protection. Nonetheless, situations of clear abuse of limited liability to evade obligations may warrant more highly targeted response that do not unduly impinge upon the broader business community.

A significant and frequent feature in the corporate social responsibility debate concerns the role of disclosure of non-financial environmental and social performance information as part of communicating corporate responsibility, and as a process for engaging with stakeholders. An absence of well understood methodology in these areas is considered a major impediment to wider adoption of triple bottom line type reporting, and moreover, contributes to a lessening of user confidence in this emergent area of disclosure. CPA Australia's submission points to a number of avenues of development that will contribute over time to the achievement of best practice.

Chapter 1 The issues of corporate social responsibility

How might corporate social responsibility usefully be described for working purposes

In its recent submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC), CPA Australia made reference to and commented upon the following two definitions or descriptions[1] of 'corporate social responsibility':

> " - - - behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation".[2]
>
> and
>
> "the resolution of nearly every issue of corporate social responsibility depends heavily on one's beliefs about how the political process operates and one's convictions about the ideal political process".[3]

These descriptions are useful alternatives as they focus on the business decision perspectives of risk management and on balancing short and long term viability. Moreover, they highlight the complexity of interrelated factors at play in the corporate social responsibility 'debate'. CPA Australia believes that there is a danger in allowing possibly subjective or extreme views to impact upon the overwhelming positive economic contribution and commercial certainty afforded by the corporation and limited liability. Where there is abuse of the corporate form or a failure to meet evolving community expectations, solutions need to be highly targeted and cognizant of the most appropriate avenue for effecting positive change.

Which approach or combination of approaches to responsible corporate behaviour is most appropriate

CPA Australia in its submission to PJC[4] identified two approaches to building awareness of third-party interests as an adjunct to conducting business in a socially responsible manner:

- empowerment of interest groups, and
- managerial voluntarism directed at greater organisational 'openness'.

As noted in our response generally in Chapter 3, and specifically in relation to question 5 herein, notions of interest group empowerment are problematic. In contrast, *managerial voluntarism* when viewed from the perspective of the emerging utility of non-financial information presents, in CPA Australia's view, a significant avenue for incremental development in both stakeholder engagement and management sympathy for the environmental and social dimensions of business. Development can thus occur, without adversely impacting upon the established and well defined reach of corporate law.

As Parkinson observes:

> " - - - the mere fact of being under a duty to disclose information is not in itself a reason for companies to change their behaviour."[5]

[1] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 11-12.
[2] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) pp 260-262.
[3] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1.
[4] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 31-32.
[5] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 372.

The suggested reorientation in the discussion of 'Triple-bottom-line' reporting away from an overwhelming emphasis on external reporting to that of an understanding of the management and utilization of inward flows of information, potentially generates more enduring benefits through:

- an increased capacity for compliance with substantive environmental and social laws,
- motivating the establishment and scrutiny of risk management systems, and
- encouraging responsiveness to the impact of business on the physical and social environment.

As such, 'Triple-bottom-line' reporting would flow as a consequence of continuously improving and adaptive management practices rather than as an end in itself.

What are the incentives or disincentives for a company to conduct its business in a socially responsible manner

In its submission to the PJC, CPA Australia expressed the view that a profit imperative and conducting business in a socially responsible manner are by no means mutually exclusive, it clearly demonstrable on a number of fronts that the adoption of innovative and sustainable practices can generate competitive advantage.[6] Those companies that are capable of demonstrating a capacity to manage environmental risk, may likewise be able to command a premium based on this capacity.

Similarly, an increasingly educated and informed consumer market, potentially assisted by emerging levels of voluntary non-financial disclosure, can through its choices act as a source of informal licence by which business survival is dictated.[7] In these terms, those business with an ethos towards continuous adaptability will more likely be the ones that prosper.

Conversely, the present thrust and structure of the Corporations Act, and the wider legal framework within which business regulation operates, cannot be regarded as either an impediment or a disincentive to business being conducted in a socially responsible manner.

The development of incentives which negate the negative environmental or social impact of the conduct of commercial activities within liberal democracies such as Australia, demands consideration of a wide spectrum of policy settings extending beyond corporate law. Aside from an understanding of the limitations of corporate law in contrast to more substantive environmental and social public law, regard needs to be given to wider policy considerations. This should occur in such domains as determining the scope for the taxation system to alternatively penalise or promote environmental and social interests, and the manner in which choices are made in relation to infrastructure renewal, to name just a few.

Equally, resolving such concerns involves both an understanding of the interactions of various market forces and identifying the means by which the attitudes of the wider community might be shaped towards more socially responsible outcomes. To suggest that the problems which beset our environment and society are primarily a consequence of rapacious corporate behaviour clearly overlooks the expectations as to what are acceptable levels and types of consumption. The behaviour of many corporations merely

[6] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 14-15.
[7] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 18.

mirrors societal expectations as to the scale and type of consumption that has come to be expected.

Do different or additional implications arise depending on the nature or size of the enterprise, for instance:
- the sector or industry in which an organisation operates
- whether a company has international operations

There is compelling logic in the idea that corporate social responsibility should be an enterprise size neutral concept – the driving factor being the nature of the undertaking and its environmental and social reach. Whilst disclosure is a vital avenue for communicating environmental and social performance, and therefore engagement with stakeholders, the impact of mandating additional reporting requirements on smaller entities needs to be well understood before a particular solution is advanced through public policy.

Specific reference to cross-border operations may be appropriate to deal with circumstances where the choice of location of corporate operations or assets might be motivated by a specific jurisdiction's lesser environmental, labour or further social laws, or additionally, driven by a desire to protect assets from the reach of regulators or claimants arising out of a breach of an environmental law or civil wrong.

In practice:
- to what extent is corporate decision-making driven by stakeholder concerns
- how do companies differentiate between various categories of stakeholders
- in what ways do companies balance or prioritise competing stakeholder interests, and
- how do companies engage with stakeholders

To what extent is corporate decision-making driven by stakeholder concerns
Both theory and practice overwhelmingly support a commercial rather than a stakeholder concern objective in corporate decision-making. This position is acknowledged without necessarily inferring a position of extreme member primacy that would be manifest in short-term profit or member wealth maximization.

The formation of a company is clearly predicated upon the capacity to avail of limited liability through which participation in an enterprise is ensured through certainty as to the extent of exposure to liability.[8] As the authors of Ford's state in their introductory discussion:

> "The privilege of limited liability achievable by formation of a company is not a fundamental human right. It is a franchise given by society to save members from having to seek limitation of liability by more cumbersome methods."[9]

As indicated in our submission to PJC,[10] the granting of the concession of limited liability facilitates private behaviour within bounds of an understanding that it is necessary to maintain a threat of constraint within the law. To regard corporate decision-making as driven by stakeholder concerns, would draw director and management attention away from the interests of those persons for whom the privilege of limited liability is granted, and

[8] It is acknowledged that limited liability may in more extreme circumstances offer a 'perverse incentive' by which there is enabled excessive risk taking, avoidance of emergent liability or the sheltering of assets from legitimate claim. The nature of this abuse warrant highly targeted legislative, and possibly judicial, responses as foreshadowed in the Committee's separate inquiry into long-tail personal injury claims.
[9] Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (11th ed., Butterworths, 2003) [1.080].
[10] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 26.

correspondingly, create an undesirable degree of indeterminacy around the types of actions which would attract constraint.

From an alternative perspective, the company can be viewed as being established as a legal arrangement by which a collective, though fluctuating, fund is applied to predominantly commercial purposes. Notwithstanding the removal of the statutory requirement for an objects clause in the corporate constitution, the vast majority of companies are established for a presumed commercial purpose. Any significant reorientation of corporate decision-making towards being driven by stakeholder concerns, may risk depleting the 'corporate fund' potentially to the point of jeopardising creditor claims.

Nonetheless, as will be elaborated upon, a disregard for stakeholder interests will clearly be detrimental to longer-term commercial viability and potentially expose the corporation to the type of risk that would attract severe sanction under a range of laws external to corporate law.

How do companies differentiate between various categories of stakeholders, in what ways do companies balance or prioritise competing stakeholder interests, and how do companies engage with stakeholders.

Two contrasting approaches may be suggested in relation to both the differentiation/identification of, and the engagement of companies, with stakeholders. First, as described elsewhere, there is assumed a significant, though emerging, role of non-financial disclosure[11] which can provide a rigorous and comprehensive description of the quantitative and qualitative performance of business in environmental and social dimensions. Such information can, as with more formalised financial reporting, be regarded as a free 'public good'. Through these developments, a broadening body of stakeholders may be empowered to make their own assessments as to the conduct of a specific company or industry, through which, in turn, a basis of reasoned dialogue may emerge.

Secondly, and more specifically, it is acknowledged that there is an increased trend, particularly observable amongst companies in the extractive industries, where engagement with the community is seen as a vital part of managing the full scope of complex projects. Such instances of 'enlightened self-interest' being highly specific to a company's unique circumstances, do not lend themselves as a basis of broader prescription of corporate conduct. Developments in the direction of organisational openness, are rather, the consequence evolving attitudes that can be encouraged but not compelled.

In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company

CPA Australia has sought to address these issues by way of conducting in September 2005 a survey of consumer confidence in corporate reporting focusing specifically on issues of attitude and expectation around corporate responsibility. A copy of the research results are enclosed.

A wide range of questions were canvassed amongst a cross-section of users and preparers of corporate disclosure information, and the wider public. Included were

[11] See generally CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 33-34.

questions which sought to determine decision-sensitivity to company respective environmental and social reputation.

Significantly, both the ‘Shareholder’ and ‘Directors / CEOs / CFOs’ categories in response to questions about their investment decisions expressed the view that they would be significantly discouraged by unfavourable reputation, with greater weight being given to environmental performance over that of aspects of social reputation. In turn, product and service purchase decisions seem significantly less subject to concerns about a company’s environmental and social reputation.

In terms of comparison with other categories within the research sample, the preferences of shareholders reflects to a reasonable degree the sentiments of those of the wider general public, whereas the category of ‘Analysts, Advisors & Brokers’ showed lesser sensitivity to these issues.

On the basis of these responses, it is reasonable to conjecture the presence of a relative degree of congruence of views between directors and shareholders as to the importance of corporate environmental performance. Moreover, the views of directors are not dramatically divergent from public expectations. Elsewhere in the research there is however evidence of divergence of view, particularly around such matters as to whether reporting on environmental and social practices should be mandated.

Are there any changes that could enhance triple bottom line reporting, sustainability or like reporting, including:
- increasing the level of clarity and comparability of these reports
- any suggested changes to external verification of those reports
- whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s)
- are there particular issues for small to medium enterprises

These issues are considered at length in our submission to PJC[12] in which there is described the rationale of a major research project being undertaken by the University of Sydney and CPA Australia under the auspices of the Australian Research Council.

Briefly, the project involving academics from the disciplines of accounting, physics and communications, addresses by way of applied field studies, the integration of sustainability and accounting information that will enable significantly improved internal accumulation, measurement and analysis/assimilation of environmental and social data. An absence of well understood methodology in these areas is considered a major impediment to wider adoption of triple bottom line type reporting, and moreover, contributes to a lessening of user confidence in this emergent area of disclosure. Difficulties in this regard may be particularly pronounced for small-to-medium size enterprises who are less able to marshal the necessary resources to embark upon non-financial reporting.

It is further anticipated that improved outcomes will be facilitated through the flow and utility of information for decision-making which is essential to improve performance and risk management in these domains. Improvement in the quality and utility of non-financial disclosure, and the opportunity for wider take-up, will thus flow as a direct consequence of this more integrated approach. Nonetheless, development in this direction should be allowed to emerge over time, rather than pursuing ‘quick fix’ mandated prescriptive

[12] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 33-37.

approaches which potentially fail to capture firm specific characteristic and which would likely attract an attitude toward minimum compliance.

Noteworthy also is the extent to which enhancement of non-financial data management will be highly complementary to enabling appropriate standards and levels of assurance of sustainability and triple-bottom-line reporting. The current form of Australian guidance is described in recently released CPA Australia / University of Sydney research[13]:

> "In June 2003, the Audit and Assurance Standards Board (AuASB) issued AUS 110: *Assurance Engagements other than Audits or Reviews of Historical Financial Information.* This standard establishes basic principles and standards to be applied by auditors when completing work such as verification of sustainability reports. - - - It should be noted that AUS 110 does not call for audit of non-financial information, but prescribes principles that should be followed in the event that such an audit or review is undertaken."

Research conducted by the University of Sydney on behalf of CPA Australia highlighted within the limited take-up of triple-bottom-line reporting, relatively fragmented approaches to the application of external assurance and verification.

CPA Australia would further like to draw the Committee's attention to work currently being undertaken by the International Audit and Assurance Board (IAASB) of the International Federation of Accountants (IFAC) in relation to assurance issues arising out of the release for public comment by the Global Reporting Initiative (GRI) of its version three of Guidelines.

[13] http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-69D42C6A/cpa/sustainability_reporting_asia_pacific.pdf

Chapter 2 Directors' duties: current position

Whether and in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions

Consistent with the notion of proximity, directors' duties of care and diligence are regarded as being owed to their companies[14] on the basis of relationship and obligation. Similarly, the analogy of a fiduciary is applied to ensure loyalty of directors to act for the benefit of the company, and by inference shareholders.[15] Nonetheless, focusing management attention on the "continued health of the corporation" should allow reasoned regard for a wider constituency of interest affected by the companies' activities.[16]

Directors duties have evolved to regularise the company / member / director relationship within the bounds of limited liability and separate corporate legal personality. The wider community does however derive a benefit by way of an assured level of integrity in the conduct of corporate affairs.[17]

This description of the scope and limitations of corporate law provides a significant indication of the proper demarcation between particular branches of the law and the objectives to which they are put. Advancement of environmental and community interests are best pursued by targeted legislation to which corporations, along with all citizens, are subject.[18]

Those instances where the corporate form itself might be regarded as a source of 'perverse incentive' by which regard for a legitimate interest is evaded, such as those of long-tail tort claimants, should attract highly targeted forms of intervention which do not adversely impact upon the wider business community.[19]

It is acknowledged that there is criticism[20] of the corporate law / environmental law 'dichotomy' as functioning within a presumed development paradigm in which environmental concerns are balanced against overarching economic development imperative. However as previously noted, any suggestion of a departure from the economic premise of incorporation and limited liability presents far reaching implications. CPA Australia respectively suggests that such deliberations would need to take place in a forum wider than the Committee's current scope, in which the possible trade-off of living standards and the community's preferences could be more comprehensively explored.

[14] CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, p 14.

[15] M. Whincop, "Overcoming Corporate Law: Instrumentalism, Pragmatism and the Separate Legal Entity Concept" (1997) 15 *Company & Securities Law Journal* 411 at p 422.

[16] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 20-21.

[17] *Darvall v North Sydney Brick & Tile Co Ltd & Ors* (1989) 15 ACLR 230 at 231 per Kirby P.

[18] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 21 and p 26.

[19] In this regard, CPA Australia notes CAMAC's call for submissions in response to a Ministerial referral in relation to the treatment of future unascertained personal injury claims.

[20] See Bielefeld, Higginson, Jackson and Ricketts, "Directors duties to the company and minority shareholder environmental activism" (2004) 23 *Company & Securities Law Journal* 28 at p 30.

If so, is there any useful scope for clarifying the current law in this respect

The Corporations Act[21] presently provides in relation to directors' business judgements a 'safe harbour' protection from judicial scrutiny and shareholder challenge. This protection relates directly to decisions within the ambit of the duty of care and diligence. Given the scope for directors to have regard for a wider constituency affected by their decisions, CPA Australia suggests that certainty in the law and encouragement of good corporate conduct could be achieved by extending this type of protection to decisions within the loyalty obligations of good faith and acting in the best interests of the corporation.[22]

Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making

Within the often quoted notion that "directors must act bona fide for the benefit of the company as a whole"[23] there is clear scope for balancing short and long-term considerations within an understanding of member interests; present and future. Similarly the duty being owed to the company as a distinct entity likewise supports a balancing of the short and long-term.[24]

The adaptation of fiduciary obligations is capable of accommodating evolving expectations of the function of the company within society and the presumptions of the strictness of shareholder primacy: "a classic theory that once was unchallenged must yield to the facts of modern life".[25] Nonetheless, it is again emphasised that this concept, though dynamic and reflective of changing realities, still fulfils the primary function of protecting shareholders who are vulnerable to managerial opportunism. Thus any development in the law of directors' duties towards a formalised recognition of non-shareholder stakeholder interests, potentially creates uncertainty in the conduct of a corporation's affairs.

Are any changes needed to the current law regarding the rights of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?

The capacity of shareholders to express their views by way of resolution is provided for in Division 4[26] of Part 2G.2[27] of the Corporations Act with the key operative section being s 249N (Members' resolutions). The authors of Ford's in commenting on this section note that members may not use the powers to requisition a meeting and demand a motion to be put where, "the subject is a matter of management exclusively vested in the directors".[28] Any change from this established position, CPA Australia believes, would only be tenable as part of a substantive shift in the division of corporate powers, for which the current Inquiries or elsewhere present no compelling evidence.

[21] Section 180(2)

[22] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 23-24. It should further be noted this form of protection should more than likely not extend to the 'proper purpose' second limb of s 181(1) given the more specific types of powers covered.

[23] *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J.

[24] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 16-19.

[25] *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 at 313-314 per Berger J.

[26] Members' rights to put resolutions etc. at general meetings

[27] Meetings of members of companies

[28] Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (11th ed., Butterworths, 2003) [7.123]. The authors cite with approval the authority of McLelland J in *NRMA Ltd v Parker* (1986) 6 NSWLR 517, stating "on balance, McLelland J's approach should be supported".

Ancillary to the powers granted to members in general meeting, is the law of member remedies.[29] Here CPA Australia suggests[30] that there is room for cautious development to enable members to make enquiry about their companies' compliance and risk management procedures in relation to substantive environmental, social and civil wrongs laws. Conversely, an understanding of the scope of these members' remedies operating in parallel with the powers of the courts to grant relief,[31] should provide protection from unreasonable challenge by members where a decision on a matter of environmental or social concern is arrived at honestly.

[29] Corporation Act 2001 Part 2F.1 Oppressive conduct of affairs

[30] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 24-25.

[31] Corporations Act s 1318 Powers to grant relief

Chapter 3 Directors' duties: matters for consideration

Should the Corporations Act be revised 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?

CPA Australia believes that the possibly prescriptive and more highly rule-based approach alluded to in this question may in fact operate against the flexibility described in our response to question 3 of Chapter 2. Directors are able to identify emergent stakeholder interests as part of safeguarding long-term commercial viability. To state that directors "may take into account" does not necessarily translate into positive action. Positive development in this direction will emerge more effectively from an enlightening of attitude which, in turn, is likely to arise as a consequence of education and leadership. Nonetheless, to reiterate the point previously made, the law should be amended to clarify the protection of directors making such stakeholder based initiatives where determined in the overall long term interests of the company.

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

CPA Australia rejects development in the Corporations Act in the manner suggested.

Presently the Corporations Act does not specifically recognise particular classes of shareholder. Thus to introduce into corporate law the notion of classes of stakeholder for which there is not an established basis of legal obligation, would suffer problems of indeterminacy.

CPA Australia in its 2005 Confidence in Corporate Reporting survey, canvassed the views of a cross-section of business professionals, shareholders and the wider public who ranked shareholders and employees as the primary categories of stakeholder. The next most clearly recognised categories of stakeholders were creditors and the local environment, with customers, the local community and future generations ranking further behind. The interests of a number of these categories of stakeholder are precisely defined by contract, and particularly with respect to employees, more targeted provision is made to address specific vulnerability arising from corporate insolvency. Similarly the Act's insolvent trading provisions[32] affords to unsecured creditors an appropriate degree of protection without creating a more formalised duty within directors' general duties; the impediments to which are identified in our response to the PJC.[33]

The remaining interests of the environment and community, though comparatively nebulous, are nonetheless protected in the manner described in our response to Chapter 2 by means of effective and vigorously applied public laws having their own structure of appropriate of sanctions and remedies. Additionally, the imprecise and possible shifting nature of these interests, are moreover, best addressed from the company's perspective via voluntary engagement potentially fostered by improved practices in non-mandatory disclosure.

[32] Part 5.7B – Division 3 – Director's duty to prevent insolvent trading

[33] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 16-17.

Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties

CPA Australia suggest that a worthwhile understanding of the issues raised in this question can be gained from the perspective of the internal management of the company, and how in turn, these rules relate to the exercise / division of corporate powers.

Consistent with the notion of the corporation as an association of individuals who come together for commercial gain protected by limited liability, the corporate constitution (and replaceable rules) which regulates the internal dealings of the company, functions as a contract between the company and its members, amongst the members and between company and its directors; though significantly not between the directors and members.[34] Both statute[35] and case law[36] establish that the responsibility for management of the company rests with the directors.

The structure of directors' duties contained in Part 2D.1 thus, to a large degree, functions to align the behaviour of director with the interests of the members, who upon forming or joining the company, are unable contract with directors to ensure full congruence of behaviours.

It is CPA Australia's view that this vital cohesion which has emerged over time within the wider scheme of the corporate law, would likely be damaged were it sought to be adapted to safeguard of the interests of other stakeholders.

Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only

Again, CPA Australia would like to reiterate that changes to the substantive law are not warranted, thus any amendment should be directed at clarifying what is already supported by, or pointed to, in the present understanding of the statute and associated case law. On this latter point, we would like to draw attention to the operation of s 185[37] which gives equal footing to general law rules in the treatment of directors' duties.[38] As such, this section provides a vital means by which the law of directors' duties can evolve through case law development to reflect changing needs and expectations.

This capacity for change is clearly identifiable in the development in the evolving judicial understanding of the duty of care and diligence.[39]

[34] Section 140

[35] Section 198A

[36] *John Shaw & Sons (Salford) Ltd v Shaw* (1935) 2 KB 113 at 134 per Greer LJ. See CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, pp 5-6.

[37] Interaction of sections 180 to 184 with other laws etc.

[38] See CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, p 4.

[39] See for example *Daniels & Ors v Anderson & Ors* (1995) 16 ASCR 607 at 661 "neither the law about the duty of directors nor the law of negligence has stood" per Clarke and Sheller JJA, and further quoting Tadgell J in *Commonwealth Bank of Australia v Friedrich* (1991) 5 ASCR 115 at 126: "As the complexity of commerce has gradually intensified - - - **the community has of necessity come to expect more** than formerly from directors whose task it is to govern the affairs of companies". (Our emphasis)

If a pluralist approach were adopted:
- should directors be permitted to take into account the interests of specific classes of stakeholders or the community when making corporate decisions, or alternatively
- should the directors be required to take into account the interests of specific classes of stakeholder or the community when making corporate decisions
- in either case, what broader interests should be identified
- how might any proposed amendment be implemented and enforced?

CPA Australia is of the view[40] that there exists valid political and economic barriers to the adoption of a 'pluralist' approach, along with further even more radicals views such as the 'corporation as community'.

As an alternative perspective, again referring to the work of Parkinson:

> "It is quite possible that the arrangement [that companies exist to make profits for the benefit of shareholders] is the one that is most conducive to the public good. But the point is that making profits for shareholders must now be seen as a mechanism for promoting the public interest, and not as an end in itself."[41]

This notion of the corporation as a 'social enterprise', CPA Australia suggests, might form a better basis for identifying approaches to balance legitimate public interest, whilst recognising the profit motive and the essential proprietary nature of shareholder participation which underpins much of Australia's economic activity.

Again reiterating comments made elsewhere, what is required is a balanced approach focusing on education and a changing of attitude amongst directors, shareholders and the wider community, whilst at the same time ensuring the essential commercial orientation of the corporation.

If an elaborated shareholder value benefit approach were to be adopted:
- what form should it take
- would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments
- how might any proposed amendment be implemented and enforced?

Whilst acknowledging merit in the concept of 'enlightened shareholder value', CPA Australia suggests that the cautious approach to the development of directors' duties described in our response to Chapter 2 questions, offers more targeted and certain outcomes, whilst at the same time presenting avenues for ongoing development that reflects incremental shifts in community expectations. Again, it is emphasised that there should not be underestimated the capacity of case law as a parallel source for guiding appropriate development in the law of directors' duties.

The UK development does not seem in any way to suggest the creation of an actionable right for non-shareholder stakeholders, and importantly, reiterates the unique position of unsecured creditors in circumstances of impending insolvency. Nonetheless, there should be acknowledged the current appropriate balance of considerations contained within Australia's present laws of member remedies and meetings of members.

[40] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 25.
[41] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 23.

Chapter 4 Corporate Reporting

Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities

Aside from any specific reporting requirements contained in environmental, labour or wider social oriented public laws, the most direct disclosure requirement relevant to corporations is that contained in s 299(1)(f) of the Corporations Act - the provision requiring directors to report on performance in relation to significant environmental regulation. Given the inclusion of this requirement within the *Annual financial reports and directors' reports*[42] provisions, consideration of possible enhancement or strengthening needs to be considered in the wider context of emergent regulation and evolving practice in this area.

The authors of Ford's[43] express the view that the requirements of s 299 can be met in a "relatively constrained fashion" falling somewhat short of the more discursive requirements contained in 'management and discussion analysis' as adopted in some overseas jurisdictions. Nonetheless, the introduction of s 299A[44] as part of the CLERP 9 Act 2004, along with authoritative comments,[45] indicate a clear trend towards greater rigor in the preparation of such disclosures and the adoption of a MD&A 'philosophy', though significantly without pursuing highly prescriptive or mandated approaches.

In addressing the further development or enhancement of s 299(1)(f) in this context, CPA Australia suggests that there is scope for implementing best practice guidance specific the this section, developed perhaps in cooperation between ASIC, the ASX Corporate Governance Council, the Department of the Environment and Heritage, and the professions. As a source of guidance, this may loosely be drawn from the experience gained in developing ASIC's s 1013DA[46] disclosure guidelines[47] and the work undertaken by DEH in relation to departmental and agency reporting under the Environment and Biodiversity Conservation Act 1999.[48] Significantly, the adoption of a principle based approach such as this, would enable refinement over time as preparers gain greater experience in the practicalities of such reporting.

Are any changes desirable to any other reporting requirements, such as the ASX Listing Rules requirements, the ASX Corporate Governance Principles or the relevant accounting standards, to provide more relevant NFI to the market

As with the thrust of our response to question 1 above, CPA Australia believes that the current structure of rules presents an appropriate framework within which practice may develop, with the assistance of targeted guidance, to meet emergent expectation and needs in relation to the disclosure of corporate environmental and social performance. To this end, CPA Australia acknowledges and broadly commends the current initiatives of the ASX Corporate Governance Council in its review of the applicability of Principle 7[49] of its

[42] Division 1 of Part 2M.3 Financial Reporting
[43] Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (Lexis-Nexus Online) [10.230].
[44] Annual Directors' Report – additional general requirements for listed public companies
[45] The authors of Ford's make reference in particular to the G100 and the recommendations of the HIH Royal Commission.
[46] Information about ethical considerations etc., Pt 7.9 – Div 2 – product Disclosure Statements of Chapter 7 Financial Services and Markets
[47] "ASIC guidelines to product issuers for disclosure about labour standards or environmental, social and ethical considerations in Product Disclosure Statements (DPS)"
[48] section 516A Annual report to deal with environmental matters
[49] Recognising and managing risk

Principles of Corporate Governance and Best Practice Recommendations to the description of sustainability and corporate responsibility risk.

In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form

It is CPA Australia's view that where possible information on the environmental and social performance of companies should be quantitative as this reduces subjectivity, aids comparison of performance over time and on a cross-sectional basis between companies, and moreover, enhances the scope for independent assurance. Noteworthy towards this end, is the inclusion of a wider and more comprehensive range of metrics within the latest draft version of the GRI. Nonetheless, particular dimensions of performance are best captured and encapsulated in narrative comment – here again the focus of the type of guidance development describe above should be on an understanding of user utility and comprehension.

Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles

Aside from the comments made elsewhere in relation to this Chapter of the Committee's discussion paper, CPA Australia would like to stress that consideration of the aspect of measurement raised by this question needs to be cognizant of the existing framework and details of accounting standards, which as legislative instruments, should prevail.

Would an additional environmental or social 'impact' reporting obligation be appropriate and feasible and, if so, how might it be stated?

Referring to our response to question 1 above, it is CPA Australia's view that the present reporting requirements contained in corporate law, assisted by the cooperative development of appropriate guidance, present a sound framework within which environmental and social reporting may evolve. This coupled with the building of internal non-financial information collection and assimilation capabilities,[50] and the emergence of frameworks such as the GRI, thus precludes for the present time the necessity for additional 'layers' of reporting obligations.

At a more applied level, CPA Australia suggests that a further avenue of required development that will emerge over time, is in the realm of practices and methodologies which assist preparers of sustainability reports to identify and measure their reporting boundary in terms of supply chain and full life-cycle impacts ("sustainability footprint").

[50] Refer our response to Chapter 1.

Chapter 5 Encouraging responsible business practices

To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance

Consistent with the themes developed in our responses to Chapter 4, and moreover generally elsewhere in our submission, CPA Australia believes that advancement of corporate social responsibility requires a balanced understanding of the interaction of various regulatory settings and the importance of cooperatively developed guidances which underpin voluntary practices.

In this regard we would like to reiterate a key substantive issue raised in our submission to PJC[51] concerning the nature of 'command and control' regulation and its suitability to corporate social responsibility. As with other branches of the law, there is an undisputable requirement for strong and certain corporate legislation, complemented by general law principles, which address errant behaviour whilst adding certainty to the conduct of corporate affairs. Nonetheless, given the comparatively imprecise and possibly shifting nature of corporate social responsibility, highly legalistic rule based approaches will not of themselves create willingness towards openness and engagement, and may in fact encourage amongst some an attitude of minimum compliance, or at worst, evasion.

Similarly, it must be understood that the significant cost involved in any shift towards mandating higher orders of non-financial disclosure will be borne by preparers, and that as such, there needs to be considered the context of an understanding of the decision utility of such information amongst users.

What lessons might be derived from any experience with voluntary initiatives

Refer above response.

What would be the nature of any proposed initiatives, what would be its intended purpose and consequences, how might it be implemented and what would be its costs and other implications?

As a concluding comment, CPA Australia would like to point to its recent research on Regulatory and Professional Initiatives across the Asia Pacific. This research was motivated by a desire to gain an understanding of governance practice and environmental performance reporting reforms implemented broadly in response to the East-Asia debt crisis of 1998. The findings compiled by the University of Sydney show a significant degree of diversity, if not fragmentation and inconsistency, amongst the regional economies. Given the point made in our response to question 4 of chapter 1 that development of sustainable and responsible business practices need to be cognisant of the regional and global impact of corporate behaviour, CPA Australia tentatively suggests that there may be a role for the Australian Government to encourage development and appropriate levels of harmonisation of these practices.

[51] CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 30-32.

42/120 Collins Street
Melbourne 3000

GPO Box 1472
Melbourne 3001

Telephone +613 8664 2664
Facsimile +613 8664 2666

www.bca.com.au

24 March 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

By email to john.kluver@camac.gov.au

Dear Mr Kluver

CAMAC DISCUSSION PAPER – CORPORATE SOCIAL RESPONSIBILITY

The Business Council of Australia (**BCA**) welcomes the opportunity to make a submission to the Corporations and Markets Advisory Committee (**CAMAC**) in relation to its Discussion Paper on Corporate Social Responsibility, November 2005 (**Discussion Paper**).

As you are aware, in September 2005, the BCA made a submission to the inquiry by the Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) into corporate responsibility and triple-bottom-line reporting (**PJC Submission**). The BCA also appeared before the PJC at a public hearing held on 23 February 2006. We attach a copy of the PJC Submission and the Hansard transcript dated 23 February 2006 (**Hansard**).

The principal arguments raised by the BCA in its PJC Submission are as follows:

- Corporate Social Responsibility (**CSR**) is difficult to define and means different things to different people. There is no 'one-size-fits-all' definition of CSR. For the BCA, the essence of this issue can be captured as follows:

  > *Corporations operate within the community. For corporations to be sustainable and successful in the long term, they need to engage with the community and take account of community attitudes. Successful companies therefore factor into their forward strategies activities that manage the challenges and risks to the community and capture the opportunities that community engagement can bring. To be valid, these activities must deliver benefits both to the community and the shareholders of the corporation.*

- CSR initiatives within a company follow a maturity cycle, so that companies that are initially undertaking CSR initiatives may be more likely to undertake corporate philanthropy, but as the company matures and understands the business case for CSR, the company will be more likely to incorporate CSR initiatives into its business strategy and operations.[1]

[1] See Deloitte and Our Community.com.au, "Community Business Partnerships- In search of the modern marriage" Business Community Intelligence Magazine, October 2005, page 13.

- A company's paramount obligation is to its shareholders - but that does not mean that companies must ignore the needs of other groups of stakeholders. The two are not mutually exclusive. Increasingly companies are recognising that the long-term viability of a company (and therefore shareholder interests) are protected by recognising other stakeholder interests that impact their operations. The fact that all BCA Member companies are undertaking some form of CSR activity suggests that company directors and officers can, and do, take into account interests of stakeholders other than shareholders in discharging their duties.

- While the BCA recognises the realities of market drivers towards greater corporate responsibility, and supports corporations having regard to the interests of stakeholders other than shareholders, there are limits to the extent that corporations can and should have regard to interests other than those of shareholders. The litmus test for any activity or responsibility is whether the performance of that activity or responsibility can reasonably be seen to be contributing to the growth of shareholder value.

- Companies differ in (amongst other things) their scale, nature and spheres of operation as well as maturity and impact on the community. Accordingly their CSR initiatives and the relevant stakeholders will differ also.

- Significant changes in the nature of the economy and the environment in which companies operate have taken place. For example, growth in globalisation and technology and information flows have seen a rise in the sophistication, power and knowledge of broader stakeholders. Therefore, companies are increasingly required to take into account the interests of such stakeholders in their business operations, and there is increasing recognition of a business case for companies to undertake CSR practices. The BCA has identified some of the drivers of the business case for CSR, including:

    - ***employee recruitment, motivation and retention*** - the reputation of a company affects its desirability as a potential workplace. It is in a company's strategic interests to attract and retain the most highly skilled and expert employees, and this can be encouraged by maintaining an ethical and attractive reputation;
    - ***learning and innovation*** - learning and innovation involves companies responding to changes within society to achieve and take advantage of business opportunities, to develop new business practices and to maintain or enhance competitiveness;
    - ***reputation management*** - business success is highly dependent on reputation within the community. Advances in information and communication technology (as noted above) and the breadth of stakeholders that can influence business today means reputation is increasingly important. Reputation can affect, among other things, consumption, investment and employment decisions;
    - ***risk profile and risk management*** - by identifying possible risks, through the use of CSR initiatives, a company may be able to reduce or eliminate avoidable risks and losses (such as those related to damage to reputation or operations, or changing community attitudes);

- ***competitiveness and market positioning*** - the long-run viability of a business depends on its strategic positioning which includes developing the economy and community in which it operates, working with Government to facilitate better regulatory regimes or integrating environmental breakthroughs into assets to reduce lifecycle costs and improve efficiency;
- ***operational efficiency*** - the operational efficiency or capacity of a company depends on many factors, such as the ability to source skilled workers, the efficient use of company resources and/or the maintenance of a healthy local community to support the company's operations;
- ***investor relations and access to capital*** - investment capital is important for a company's ongoing activities and ability to expand or enter into new ventures. Advancements in technology have ensured that investors have greater access to information about a company's operations, including its social and environmental performance. There is evidence that investors are increasingly taking into account a company's social and environmental performance when making investment decisions; and
- ***licence to operate*** - companies are realising that their long-term viability depends on the continued support of the wider community and stakeholders, including customers, employees, shareholders and the local community.

- The importance of these drivers and the business case for CSR is clearly demonstrated by the extent, scope and innovativeness of the CSR initiatives being undertaken by BCA Member companies. The BCA undertook a survey of BCA Member companies and found that all BCA Member companies were conducting some form of CSR activity and that about one-third were reporting on their CSR activities.

- **The difficulty in defining CSR, as well as the fact that CSR activities are already being pursued in Australia by large corporations, suggests that mandating CSR through legislative intervention runs the very real risk of stifling the innovative and creative approaches to CSR that are already being adopted by Australian companies.**

- There are options other than regulatory alternatives that are likely to foster a more meaningful dialogue on CSR issues and create forums for companies to educate and learn from each other about CSR approaches and initiatives.

CAMAC Terms of Reference

The Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, has requested CAMAC to review and report on the matters outlined below:

1. Should the Corporations Act be revised 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?

2. Should the Corporations Act be revised to require directors to take into account specific classes of stakeholders or the broader community when making corporate decisions?

3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Each of these terms of reference are addressed in more detail below.

Terms of reference 1 & 2 – Directors duties

1. *Should the Corporations Act be revised 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?*

2. *Should the Corporations Act be revised to require directors to take into account specific classes of stakeholders or the broader community when making corporate decisions?*

The BCA does not believe that the Corporations Act should be amended to clarify or require directors to take into account specific classes of stakeholders or the broader community when making corporate decisions.

The company's paramount obligation is to its shareholders - but that does not mean that companies must, or indeed do, ignore the needs of other groups of stakeholders. The two are not mutually exclusive. The interests of different stakeholders are not necessarily competing - companies need customers, employees, suppliers and supportive communities in which to operate in order to ensure their long-term viability. Increasingly, companies are recognising that the long-term viability of their business (and therefore shareholder interests) is enhanced by recognising other stakeholder interests that impact their operations. The fact that all of the BCA Member companies are undertaking some form of CSR activity suggests that directors can, and do, take into account interests of broader stakeholders. Further discussion of these issues can be found at pages 9-13 and 45-48 of the PJC Submission.

There is no evidence that company directors and officers feel constrained by their current duties from taking into account interests of stakeholders other than shareholders. Any amendment to the Corporations Act to either, clarify the operation of the directors duties in the Corporations Act such as an 'enabling' provision, or to make mandatory the consideration of stakeholder interests other than shareholders, is therefore considered unnecessary.

The BCA also believes that such amendments could be counter-productive. This is discussed further at pages 48-49 of the PJC Submission and pages CFS 98 – 99 of Hansard.

For example, an 'enabling' provision may be counterproductive for a number of reasons, including:

- Over time, an 'enabling' provision can become interpreted such that it becomes effectively mandatory. An amendment to the Corporations Act may give the impression that there is a problem with the operation of the directors duties in the Corporations Act as they currently stand. This may lead to judicial interpretation over time that changes the 'enabling' provision to in fact become mandatory.

- Over time, circumstances can change such that issues that were not considered important in the past, may become more important in hindsight. An 'enabling' provision can run the risk of creating a legal obligation for Boards to have addressed such issues at a Board level. Given that stakeholders are such a potentially wide class (and indeed, very difficult to define or identify) this potentially raises a significant due diligence issue for Boards, to show that they identified and considered a very wide class of potential stakeholder.

- Such an amendment runs the risk of providing rogue directors or officers with a loop hole to undertake activities that might not be in the best interests of the company. For example, a particularly charismatic and dominant director may use shareholders and investors money to pursue their own personal interests through philanthropic or other activities, at the expense of the company.

Accordingly, the BCA believes that the proposed amendments to the directors' duties in the Corporations Act are unnecessary at best and counter-productive at worst.

Term of reference 3 – Encouraging companies to take up CSR

3. *Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?*

As outlined above, the BCA has identified eight key business drivers for companies undertaking CSR activities. The significance of the business case for CSR is seen in the extent, scope and innovativeness of the CSR initiatives already being undertaken by BCA Member companies. The BCA undertook a survey of BCA Member companies and found that all BCA Member companies were conducting some form of CSR activity and that about one-third were publicly reporting on their CSR activities.

Against this background of significant engagement, and coupled with the difficulties and limitations associated with 'enabling' provisions outlined above, the BCA does not support the proposed legislative responses to 'encourage' CSR activities such as amendments to the directors' duties in the Corporations Act or mandating CSR reporting.

The BCA supports government and industry initiatives that may encourage more companies to adopt CSR initiatives on a voluntary basis (if such approaches are unlikely to, and do not become, counter-productive or mandatory). This is discussed in more detail at pages 49-50 of the PJC Submission and pages CFS 92-93, 104-105 of Hansard.

There are a number of methods by which Government and industry can encourage more companies to take up CSR initiatives. To be effective, the BCA considers that any methods adopted must focus on, or relate to, the market-based drivers of CSR. Consistent with this, the BCA has identified several possible methods to encourage CSR activities, including[2]:

- identifying and removing regulatory barriers to corporations implementing CSR activities;

[2] PJC Submission, page 50.

- publicly recognising the achievements of those corporations leading the way in CSR (ie better showcasing best practice);

- raising awareness for corporations of the drivers and trends in CSR;

- providing guidance to corporations on developing and implementing CSR activities, drawing on the experiences of larger corporations; and

- facilitating discussions between businesses on approaches and experiences to CSR.

As an initial step, the Government could seek to identify and correct existing regulatory barriers to corporations implementing CSR activities. The BCA took a number of questions 'on notice' in its PJC appearance on 23 February 2006, including questions regarding examples of existing Commonwealth and State legislation and policies that may inhibit corporations engaging in socially responsible behaviour. The BCA conducted a brief survey of its Members[3] and found that there are a number of possible areas that could be reviewed to better support the take up of CSR activity (summarised below). A more extensive and timely review conducted by, or on behalf of, the Government could reveal additional areas that could be subject to reform.

- *Childcare*- Under current fringe benefits tax (**FBT**) law, employers are not required to pay FBT for employer-sponsored on-site childcare. Employer-sponsored childcare at third party facilities, however, attracts FBT. It is only feasible to offer on-site childcare where a significant share of a corporation's employees are located in large, central offices. Where however employees are spread across a range of locations, particularly in outer suburban, regional and rural locations, it is not feasible to offer all employees on-site childcare.

- *Insurance*- A common element of many CSR programs is an arrangement that allows employees to spend some of their company time volunteering with community organisations. This can raise some challenges, however, in terms of insurance cover for those employees. While recent legislative changes have given some protection to volunteers themselves, that protection is not extended to either the community organisation nor the corporate employer. Community organisations are usually not in a financial position to indemnify the corporation, nor might the corporation's own insurance cover it.

- *OH&S*- Corporations are obliged to provide safe working environments, but will have little direct influence over the working conditions of employees volunteering with community organisations. Corporations will be discouraged from allowing employees to volunteer through the company if they are uncertain of their OH&S obligations.

- *Taxation*- Many companies plan to establish corporate foundations for the benefit of the community. While a number of BCA Members have established such foundations, others have reported difficulties with taxation arrangements for their

[3] We advise that this was not a comprehensive survey of BCA Member companies and that our prime concern was to identify a range of examples quickly. The examples given should not therefore be considered exhaustive.

foundations, particular in relation to gaining Income Tax Exempt Charity Endorsement or the Deductible Gift Recipient Status for corporate foundations.

The Government could also examine ‘business case’ or ‘market-based’ approaches that have been used successfully overseas to better encourage or support CSR activities.

- In the UK for example, the Government has established a CSR website www.csr.gov.uk that outlines the initiatives that the Government are using to encourage business to undertake CSR activities.

- Also, the UK Minister for CSR provides an update report on Government initiatives to encourage companies to undertake CSR activities. In one of the reports the Minister for CSR recognises that ‘encouragement’ of a voluntary nature is an appropriate approach for Government:

> *I am well aware of the many and increasing calls for more regulation of company behaviour. And I agree that Government has a responsibility to ensure minimum legal standards. I remain convinced that the main focus of CSR should continue to be a voluntary one. Our role in Government then is to be clear on the future direction and the challenges facing us and to set the appropriate framework that enables us to tackle them……*
>
> *We want to encourage more to follow suit but we recognise the need for a flexible rather than a “one size fits all” approach.*[4]

While the BCA does not support the legislative responses that have recently been taken in the UK, there may be other initiatives developed in the UK or elsewhere from which Australia may learn. The approaches being taken overseas are dynamic and evolving. Therefore, it may be possible for Australia to learn from these experiences (where they fit within the social and economic objectives and philosophy of our country) before serious consideration of any legislative action.

The BCA considers that Governments should work with industry and business to develop voluntary initiatives to encourage greater CSR activity, based on market drivers and offering the flexibility for companies to learn about and undertake CSR based around their own unique business activities and circumstances. Governments in Australia are already involved in many areas relating to CSR through, for example, the Prime Minister’s Business Community Partnership. However, there may be other opportunities for cooperation between Government and the private sector.

For example, to support the wider adoption of CSR by business, the UK Government has been exploring the benefits of CSR for general business performance. The UK Government has worked with others on projects looking at the links between CSR or sustainability and business performance, both in terms of the impact on the competitiveness of individual companies and national economies[5].

[4] UK Government, “Corporate Social Responsibility A Government update”, www.csr.gov.uk, May 2004, page 4.

[5] UK Government, “Corporate Social Responsibility A Government update”, www.csr.gov.uk, May 2004, page 10.

Enhanced education and knowledge of the business drivers of CSR can also be provided through workshops and forums with various industry and government participants. The more education and information provided to government, private business and the community about the business case for CSR, the greater the pressure will be for the implementation and up-take of CSR activities.

Term of reference 4 –CSR reporting

4. *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*

Despite the absence of mandatory CSR reporting requirements, the BCA has found that around one-third of its Members report on CSR in some form. Given the strong business case for CSR, it is perhaps somewhat surprising that more companies are not reporting their CSR activities. Given the importance of improving understanding of the benefits of CSR, the BCA will do what it can to encourage Members to better publicise their CSR activities. The BCA does not believe, however, that mandatory CSR reporting is an appropriate step to encouraging more effective CSR activities and their reporting. Mandatory reporting runs the risk of stifling innovation and fostering a 'tick the box' mentality. Further, it would be very difficult to mandate meaningful and consistent reporting, given that:

- companies are diverse in their maturity, operations and scope, and therefore have different reporting and content requirements. There is no 'one-size-fits-all' approach to CSR or its reporting. For example, Rick Allert, Chief Executive of Coles Myer has highlighted that even within the business, different divisions have different responses to CSR because of their unique operations. Mr Allert has stated[6]:

  > *At Coles Myer we observed that we had been supporting community in a diverse way, but in doing so it didn't lead to a coordinated approach. So we decided to bring it all under one umbrella. While that is so, our brands such as Coles and Bilo in our supermarkets and Kmart, Target and Myer stores, Officeworks, Liqorland, etc. allocated some money and do have their own ways of dealing with the communities they deal with….*
  >
  > *Bilo and Kmart have moved towards programs where we have targeted our CSR initiatives towards low-income Australian families. While Target has developed a program of activities of core business in fashionable merchandise with the prevention of cancer and Myer currently supports this initiative from a children and youth perspective. So, they are just examples of how our brands might have different approaches*;

- CSR is very difficult to define and will mean different things to different companies; and

- developments both in Australia and overseas, in terms of indices and benchmarking, mean that any attempt to mandate reporting is premature and counterproductive. Benchmarks in terms of best practice are rapidly shifting and efforts to enshrine a particular approach would limit innovation and the

[6] Deloitte and Our Community.com.au, "The chairman on CSR" Business Community Intelligence Magazine, October 2005, page 5.

application of best practice, including through the adoption of emerging practices from other dynamic economies.

Further discussion on these issues can be found at pages 50-51 of the PJC Submission.

There may be some scope to examine methods of ‘encouraging’ reporting around existing frameworks. For example in the context of listed companies there are existing ASX Principles of Good Corporate Governance and Best Practice Recommendations (**ASX Principles**) relating to reporting (such as ASX Principles 3, 7 and 10). At the least, any recommendation regarding mandatory reporting ahead of an examination of the scope for voluntary guidance to be developed by industry around existing frameworks would seem premature.

Yours sincerely

Melinda Cilento
Chief Economist

29 March 2006

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Submission to the Discussion Paper on Corporate Social Responsibility

Dear Mr Kluver

AMP Capital Investors (AMPCI) is pleased to provide a submission in response to the Corporate Social Responsibility Discussion Paper from the Australian Government Corporate and Markets Advisory Committee (CAMAC). Recognising that CAMAC will access submissions to the Parliamentary Joint Committee on Corporations and Financial Services (PJC), and the closely related nature of this inquiry, we draw the attention of CAMAC to the AMPCI submission to PJC (7 September 2005).

This submission complements the submission from our Sustainable Funds Team to the PJC, addressing many of the issues raised by CAMAC in the Discussion Paper. This submission outlines issues from the perspective of AMPCI, and its investees, and as such, it may not represent the views of AMP Limited, or its related entities.

By way of background, AMP Capital Investors is one of Australia and New Zealand's leading specialist investment managers. We manage over A$88 billion for investors; it is our only focus. AMP CI has been contributing to improving the Corporate Governance of Australian companies for many years. We vote on all resolutions put at meetings of all companies in which we hold shares and engage with companies in which we wish to see an improved level of governance. As a result of this relationship with companies, we continually consider the role and performance of Australian company directors. More details on the work undertaken by AMP CI in the area of corporate governance can be found at www.ampcapital.com.au.

In addition, the AMPCI Sustainable Funds invests over 1 billion in Australian listed assets. The Funds actively consider a company's Corporate Responsibility in its investment decision making process. The Fund's Research and Engagement Handbook (available at www.sustainablefuturefunds.com) provides more information on how the Fund assesses Corporate Responsibility.

Our response to the Discussion Paper, given in Annexure A, includes our commentary on the four questions posed to CAMAC. AMPCIs views can be summarised as follows:

1. Directors should have regard to the interest of specific classes of stakeholders or the broader community when making corporate decisions because having regard to these stakeholders is necessary to:

   a. manage the crucial intangible assets of the organisation; and

   b. minimise the risk of additional regulatory and compliance costs.

   Given the disparate views expressed in the submissions to the PJC, the current expectations of directors requires clarity with respect to the extent to which they take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. Clarity can be achieved through the following, or similar, revision to the Corporations Act:

   S180(2)(d) ***rationally believe that the judgement is in the best long-term interest of the corporation, taking into consideration the interest of legitimate stakeholders and the environment.***

2. In addition, to meet the implied social contract obligations to the community implicit from allowing companies limited liability and being a legitimate party in civil society, companies need to act in a manner acceptable to society's expectations.

   A suggested revision to the Corporations Act should be:

   S180(2)(e) ***have considered community, and legitimate stakeholder expectations, on appropriate corporate behaviour.***

3. Australian companies should be encouraged to adopt socially and environmentally responsible business practices to ensure enlightened shareholder value. A variety of industry initiatives and best practice social and environmental reporting are available to assist the transition to these business practices and should be encouraged by government and industry groups.

4. Given that meeting legal requirements is the minimum standard set by the community for a company's corporate responsibility it is proposed that the Director's Report provides details on all non-compliances within the financial year. This could replace the requirements currently provided under s299(1)(f)

5. To facilitate effective disclosure of material non-financial issues, further guidelines are required to assist companies meet the intent of s299A Corporations Law. The disclosure should be of issues that directors are already aware of and considering within their current responsibility "*of discharging their duties with the degree of care and diligence that a reasonable person would exercise."* The requirement for directors to be considering these issues is not placing an additional responsibility on directors.

Thank you for the opportunity to make a submission to the inquiry and if you would like clarification on the issues raised, please do not hesitate to contact me on the number given below.

Yours sincerely

L T. Wood

Dr Ian Woods
Senior Research Analyst
AMP Capital Investors,

T (02) 9257 1343
F (02) 9257 1399
E ian.woods@ampcapital.com

Annexure A: AMPCI: Response to the Discussion Paper

The CAMAC Discussion paper raises the broad question of "*What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?"* We believe that from an investor perspective, the incentives are clear - the sources of business value and structures of corporate governance are changing. Intangible assets such as brands, intellectual property, knowledge and reputation are increasingly central to corporate success. In addition companies are also vulnerable to social, ethical and environmental risks.

Companies that take a proactive approach to managing their social and environmental responsibilities are likely to exhibit higher quality management, stronger innovation, better relations with regulators and communities, increased ability to attract and retain key staff, greater resilience to shocks and enhanced market reputation. We believe that this will result in a lower risk relative to peers and consequently a higher valuation and outperformance over the long-term.

AMP Capital's Sustainable Future Fund has looked at the relationship between a company's corporate social responsibility (CSR) performance and total shareholder return of Australia's top 300 listed companies[1]. In the study those companies that take a broader view of stakeholders and stakeholder interests were considered better at addressing their corporate responsibility. The study found that the pool of higher performing CSR companies provided an investment return statistically better, over 4 and 10-year periods, than the pool of lower performing CSR companies. The results support the proposition that there is a relationship between a company's level of corporate responsibility and shareholder return.

Our response to the Discussion Paper includes our commentary on the four questions posed to CAMAC.

1. Should the Corporations Act be revised 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?

This question implies a degree of uncertainty on the part of directors and others about the issue of accounting for the interests of stakeholders. Submissions to the PJC inquiry[2] support the assertion about uncertainty, producing a range of interpretations about role of relationships with other stakeholders and what the broader concept of "corporate social responsibility" means for company directors. Some respondents (or stakeholders) focussed on the complete suite of sustainability issues that could be interpreted as corporate responsibility actions, while others narrowly interpreted obligations, basing discussion upon common company actions currently carried out, such as the role of directors in allowing company donations. Given this disparate understanding about the space which directors should be operating within, there is little surprise that submissions indicated stakeholders were experiencing a varying extent of consideration to their interests or the interests of the community, by companies.

It is our understanding that the current Corporations Law sets out Director's duties, which include:

- A degree of care and diligence; and
- Making judgements in the best interests of the company.

In addition, there are a number of other requirements on directors under a number of other laws on conditions of labour, including occupational health and safety[3], consumer protection and the environment. However, while these laws generally make directors potentially liable for some non-compliances with the law, the obligation is to comply with the law rather than consider the interests of stakeholders.

The company is owned by shareholders and clearly has an obligation to consider shareholders, but a company's business is also a series of relationships with stakeholders, namely with suppliers, customers,

[1] Rey, M & Nguyen, T. (2005), Financial Payback from Environmental and Social Factors in Australia, AMP Capital Investors, available at www.sustainablefuturefunds.com

[2] http://www.aph.gov.au/Senate/committee/corporations_ctte/corporate_responsibility/index.htm

[3] For example see s26 NSW Occupational Health and Safety Act 2000

financiers, employees, contractors and the community. These relationships with stakeholders are important for developing and implementing a company's strategy and in the management of risk. Therefore, there is an obligation on directors to consider other stakeholders, within the context of a company's business and objective of making a profit. However, one of the challenges and responsibilities for directors is to balance the different timeframes that different stakeholders may be operating under and the tangibility of any outcome of a decision.

For example, a short-term decision to return capital to current shareholders of a company may result in poorer services to customers, ultimately leading to under-investment and poorer longer-term returns for shareholders. Alternatively directors may choose to invest in the business to improve services at the expense of returning capital to shareholders but building a long-term customer base and company profitability. In other company circumstances and after considering both and long-term issues, the directors' decision to return capital to current shareholders may be totally appropriate action.

Another example is accepting that corporate philanthropy plays an important part in maintaining a company's reputation and meeting its social contract. The specific action may not have a measurable impact on a company's reputation or a material impact on company profitability but it certainly could be in the best interest of the company. However, there appears to be some anecdotal evidence that some directors struggle with determining whether such actions would be consistent with their duties.

Given the disparate views on the role of stakeholder issues and timeframes under which directors should be operating, it is not surprising that Director's may feel uncertain about their duties. Faced with this uncertainty, it is also not surprising that some Directors may take a risk averse or a narrow legal interpretation of their duties, to the detriment of shareholders and stakeholders.

Therefore, it appears that it is appropriate to clarify the duties of directors. Clarification can be achieved through the following, or similar, revision:

S180(2)(d) ***rationally believe that the judgement is in the best long-term interest of the corporation, taking into consideration the interest of legitimate stakeholders and the environment.***

2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

There are three prime reasons why organisational decision-makers should have regard to the interest of stakeholders, other than shareholders and the broader community. It is necessary to:

- manage the crucial intangible assets of the organisation;
- minimise the risk of existing and potentially additional regulatory and compliance costs; and
- meet the implied social contract obligations to the community, implicit from allowing companies limited liability and being a legitimate party in civil society.

The prominence of intangible assets, or intangible capital, as value and growth creators, at the corporate and national level, is today widely acknowledged: McKinsey & Company[4] and others[5] have found that intangible capital constitutes between one-half and two thirds of the market value of Fortune 250 companies. An intangible asset can be a patent, copyright, brand name or trademark. It also encompasses the know-how embodied in employees and working practices; the value of relationships with suppliers and customers; and the trust of the community. The intangible capital is driven by diverse factors: innovation, human capital, organisational processes, customer, supplier and community relations. These drivers involve some of the key stakeholders for an organisation's operation.

[4] Court, D., & Loch, M., (1999), Capturing the Value, Advertising Age, 70 (46), pp. 12-15.

[5] Gu, F., & Lev, B., (2001), Intangible Assets: Measurement, Drivers, Usefulness

Therefore, ensuring good financial returns to shareholders requires the effective management and utilisation of intangible capital. That is, it requires an organisation's decision makers have regard for the interests of stakeholders critical to those intangible assets, notably employees, suppliers, customers and the community. From the perspective of most investors, it is critical that a company has a regard for key stakeholders.

Not all companies have taken the same view on how they should manage their intangible assets. Some have relied on focussing on those that have direct nexus or short-term focus to financial returns, eg focussing on brand management through public relations. Others have taken a more holistic, broader and long-term approach to managing intangible assets and hence have considered a broader range of stakeholders, for example by being a good and active corporate citizen.

While in many cases, there is alignment of interests between the long-term financial interests of shareholders and the appropriate management of key stakeholders, it is not the case all the time. Misalignment of interests or the externalisation of costs can and do exist. Examples include situations where there is a failure in the market, law or incentives, or where different values or timeframes exist between the organisational management and stakeholders. In many of these cases a particular stakeholder, including the natural environment, can be significantly adversely impacted.

Clearly governments have a role in setting minimal standards, through law, to minimise the majority of the adverse impacts of companies. However, given the complex nature of society and the relationships between stakeholders, and recognising that society's standards change with time and particular circumstances, prescriptive legal standards will not capture all of society's minimum standards for corporate behaviour. A reliance on legal standards to capture all of society's expectations will lead to an explosion of company law and place an extraordinary compliance burden on companies, with no guarantee that the outcomes will be acceptable. Therefore, if companies do not meet society's expectations and consider the interests of stakeholders, they run the risk of additional regulation and the associated compliance costs, which are likely to be higher than if the company or industry met society's expectations to begin with.

The changes to Section 180(2)(d) of the Corporations Act suggested in the previous discussion clarifies the existing duty of directors to consider stakeholders, when there is alignment between stakeholder and company interest.

In addition, companies expect to be legitimate stakeholders in civil society, making demands of governments and society and contributing to policy development. To be a legitimate part of civil society, companies need to demonstrate that they act responsibly. This means that there is a level of corporate responsibility demanded of companies, over and above what might be set out in law, which is demanded as part of the social contract between companies, stakeholders and the community. This social contract is also implicit in society granting companies the privilege of limited liability.

"Limited liability" came about from a weighing up of the cost and benefits to broader society of allowing the owners of companies the financial benefit of minimising the downside risks of entrepreneurial endeavours. It was, and still is, a privilege granted to companies by society, through company law for which companies, shareholders and society also benefits. Implicit in being granted the privilege is the responsibility to ensure that the company meets the minimum expectations of acceptable corporate behaviour and provides a benefit to society, which requires having regard to, and understanding of the impact of its operations on legitimate stakeholders.

However, the Corporations Law appears not to encourage a company to meet its social contract. This becomes particularly important at times when the company's interest, especially in the short term, may be in conflict with the community's expectation of appropriate corporate behaviour.

Therefore, through having regard for legitimate stakeholders, companies can both meet their implied responsibility as part of limited liability and being a legitimate player in civil society and minimise the risk of burdensome legal requirements. Considering the interests of many of a company's key stakeholders is also required as part of good business practice. Consequently, an appropriate requirement for directors can be achieved with the following revision:

S180(2)(e) ***have considered community, and legitimate stakeholder expectations, on appropriate corporate behaviour.***

3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?

From the investor perspective, greatest shareholder value is generated when corporations follow the maxims of enlightened shareholder value, suggesting that Australian companies should be encouraged to adopt socially and environmentally responsible business practices. These maxims include:

- socially and environmentally responsible business practices ensure that directors will focus on both short and long term consequences of business decisions;
- business practices aimed at promoting shareholder interests must consider other stakeholders such as employees, customers, suppliers, the environment and society, particularly when the business relies on these stakeholders for their success. In other words, "shareholders are not likely to do well out of a company whose workforce is constantly on strike, whose customers don't like its products and whose suppliers would rather deal with its competitors."[6]

To encourage the adoption of responsible business practices, there are a number of industry initiatives which promote and assist the transition to social and environmental responsibility. For example, The Minerals Council of Australia's Enduring Value Code has facilitated organisations to consider stakeholder interests.

There are also a number of voluntary international initiatives or standards, such as the Extractive Industry Transparency Initiative, the UN Global Compact, ILO Standards, Human Right Norms and OECD Guidelines for Multinationals which also encourage broader consideration of stakeholders including the environment and which should be encouraged.

While the intent of these initiatives is generally positive, they vary in the degree to which both stakeholders accept the initiatives, and organisations that signed or agreed to them are held accountable for fulfilling their commitments. The first is in part due to stakeholders not being involved in the development of the initiative or the sometimes low (as perceived by the stakeholders) standard of corporate responsibility set. It is also a result of perceived poor compliance/enforcement mechanisms within such initiatives and the lack of requirement to publicly report on progress.

The voluntary nature of the initiatives also raises other issues. If the initiatives are used as a way of demonstrating that self-regulation is more appropriate than new laws, some companies will take advantage of their voluntary nature and avoid or not meet their corporate responsibilities.

Notwithstanding these reservations, Australian companies should be encouraged to adopt the socially and environmental practices that these initiatives should be encouraged.

One particular area that should be encouraged in the area of voluntary reporting on a company's environmental and social performance. Reporting encourages accountability for a company's environmental and social performance, which can be important to both employees and external stakeholders. For some companies, stakeholder reporting is part of their competitive advantage in a bid to differentiate themselves in the market place. For stakeholders voluntary reporting is a way of determining which companies believe it is important to communicate to them and what issues the company believes are important.

There are a number of guidelines, most notable the Global Reporting Initiative (GRI), which provide direction on the scope and depth of the reporting to stakeholders. However, to effectively embrace consideration of stakeholder interests an organisation needs to also clearly articulate why the issues being reported are of importance to the organisation or the stakeholder.

[6] Professor Paul L Davies Enlightened Shareholder Value and the New Responsibilities of Directors. Inaugural WE Hearn Lecture, 4 October 2005

A recent study[7] found that only 116 companies among the 509 covered by the study produced reports that discussed to some extent the corporate responsibility. The percentage of Australian companies reporting is significantly lower than in many other OECD countries. As stakeholder reporting is relatively new, and there are no set requirements for reporting stakeholder issues, the quality and scope of the reports varies widely. The better reports generally tend to follow the Global Reporting Initiative Guidelines.

4. Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Despite guidelines for reporting environmental and social issues and risks (such as the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations*), many companies do not provide adequate information to enable shareholders to determine the material changes to a companies risk profile. The focus of reporting remains the short term disclosure of financial information, with a lack or absence of short term corporate responsibility performance and long term environmental and social risk.

Apart from the requirements under s299(1)(f) and s299A of the Corporations Law and the National Pollutant Inventory, there are limited legal requirements to report on the impact of an organisation's operations on stakeholders to either shareholders or other stakeholders. The absence of regulation is in an environment where many of the issues that could be reported are information that the directors of a company should reasonably expected to know or would have easy access to, e.g. compliance breaches; Loss Time Injury Frequency Rate (LTIFR); presence of a certified EMS; and donations to political parties.

Currently, there is a requirement under section 299(1)(f), namely to report:

> *"if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory—give details of the entity's performance in relation to environmental regulation."*

There are three problems with this reporting requirement as it stands. The first is that it only requires discussion about environmental regulation. The second problem is that the test of "particular and significant" has resulted in a materiality test being used by many organisations about what, if anything, is reported. This does not necessarily provide shareholders, stakeholders or the general community an assessment of the company's general environmental performance. The third problem is the reliance on director's "being aware" of non-compliances, which suggest that the directors may not have inquired or have appropriate non-compliance reporting mechanisms.

Given that meeting legal requirements is the minimum standard set by the community for a company's corporate responsibility and therefore a measure to assess whether directors are meeting their duties, it is proposed that the Director's Report provides details on all non-compliances within the financial year. This should provide an ideal corporate responsibility KPI of the director to shareholders. Therefore, section 229 (1)(f) could be changed to:

> **"*give details on any prosecutions, fines, notices, or directions by regulators, or voluntary agreements with regulators, as a result of actual, or potential, non-compliance with occupational health and safety, environmental, employment or trade practices law, or other regulation, applicable to the entity's activities.***
>
> ***For the purposes of this section, information should be reported for all operations, sites or activities for which the entity has a controlling interest or operates on behalf of other entities, whether or not there is ownership component."***

S299a requires the disclosure of non-financial information that shareholders would reasonably require to make an informed assessment of:

- the operations of the company reported on;

[7] More information on the scope of current reporting is available at www.deh.gov.au/settlements/industry/corporate/reporting/links.html

- its financial position, and
- the company's business strategies and its prospects for future financial years.

Of particular interest to shareholders should be the business strategies and prospects for future financial years, with regard for non-financial issues. For example, if extreme or unusual weather patterns affect the quantity or quality of a natural resource input, how will this effect production levels and costs, and what is the company's understanding of climate change in this scenario. What is the company's strategy to mitigate further harm from weather or climate change impacts. Perhaps more importantly for investors, what is the contribution of that company to climate change and what are its strategies to mitigate its contribution.

The Explanatory Memorandum states that this section provides the flexibility to allow disclosure to evolve over time as reporting expectations of the mainstream market change. Unfortunately some companies have tended to take a minimalist approach to reporting in general and as such are unlikely to meet the important intent of the section of appropriately informing shareholders of key non-financial information.

Other jurisdictions have taken a slightly more prescriptive view on what should be reported.

The UK's shelved Operating and Financial Review (OFR) regulations provide some valuable direction for changes to be made here in Australia. The OFR required a balanced and comprehensive analysis of, amongst other things,

> *" the main trends and factors which are likely to affect their future development, performance and position, prepared so as to enable the members of the company to assess the strategies adopted by the company and its subsidiary undertakings and the potential for those strategies to succeed."*
>
> *"The review should, to the extent necessary, provide information about:*
>
> > *a) the employees of the company and its subsidiary undertakings,*
> >
> > *b) environmental matters, and*
> >
> > *c) social and community issues."*

It should be noted that the issues that were covered by the OFR were issues that directors should already be aware of and considering within their current responsibility "*of discharging their duties with the degree of care and diligence that a reasonable person would exercise."* The requirement for directors to be considering these issues is not placing an additional responsibility on directors. It is requiring directors to report back to shareholders how they are addressing this responsibility.

A similar disclosure requirement for Australian companies under the Annual Directors' Report would be of meaningful relevance to shareholders and other stakeholders. In addition, the disclosure of such would be a measure of the extent that Directors understand and are meeting their responsibility.

The recent retraction of the OFR in the UK was in part due to reporting requirements that many British companies and those throughout the EU will need to meet under the EU Accounts Modernisation Directive (AMD). The AMD requires companies to report relevant environmental and workplace matters using key performance indicators (KPIs) "to the extent necessary for an understanding of the development, performance or position of the business of the company."

In principle, the AMD provides directors with the requirement to report non-financial information about material risks and strategies of the company, which may affect its performance:

"*…for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters."*

Again, a similar disclosure requirement for Australian companies under the Annual Directors' Report would be of meaningful relevance to shareholders and other stakeholders. In addition, the disclosure of such would be a measure of the extent that Directors understand and are meeting their responsibility.

eia
Ethical Investment Association

15 March 2006

John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001
john.kluver@camac.gov.au

Dear Mr Kluver,

INQUIRY INTO CORPORATE SOCIAL RESPONSIBILITY

The Ethical Investment Association (EIA) is pleased to make this submission in response to the Corporate Social Responsibility: Discussion Paper, released in November 2005, by the Corporations and Markets Advisory Committee (CAMAC).

The EIA is Australia's peak industry body for professionals working in the area of Sustainable Responsible Investment (SRI) and Ethical Investment and also helps individuals and organisations to learn more about how they can become sustainable and responsible investors. At present, almost every fund manager, superannuation fund and financial adviser working in the area of SRI is a member of the EIA, as are other professionals working toward similar goals.

The EIA was formed in 1999 to promote the concept and practice of SRI to an increasingly interested general public, to the mainstream investment community, to analysts, superannuation fund trustees, financial advisers, regulators, religious, charitable and other values-based organisations, government and non-government organisations and to the corporate sector.

The EIA Charter is as follows:

1. Business needs to be judged on environmental, social and governance performance, as well as their financial performance.
2. Business needs to continuously strive for improvement in all these areas of performance.
3. We support the growth of the SRI industry and believe it can assist business to improve performance.
4. We believe that SRI portfolios can provide competitive returns for investors within defined risk parameters.
5. We encourage transparency within the investment industry in order to empower investors.

The EIA also supports measures that seek to improve and promote corporate responsibility.

Question One: Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporation decisions?

Yes**.** The EIA believes that directors should have regard for the interests of stakeholders other than shareholders; that these interests should be formally incorporated into strategic and tactical decision making and, on occasion, should act as a constraint on pure profit-seeking behaviour.

This position is not inconsistent with the practices adopted by many companies. The EIA notes that some leading companies already have in place a framework and processes for taking into account various stakeholder interests when making strategic and financial decisions.

The EIA also notes that numerous company directors and peak business bodies are confident that the Corporations Act already permits such consideration to take place, and claim that it does indeed take place in many corporate boardrooms through both formal and informal processes.

However, as the Corporations Act is unclear regarding the extent to which directors may take into account the interests of other stakeholders, at the very minimum it should be revised to explicitly recognise directors' ability to consider the interests of non-shareholder stakeholders, particularly in relation to decisions that are likely to have negative environmental or social consequences.

Given that there appears to be little corporate opposition to the notion that such consideration routinely takes place, the business community should have no objection to legislated recognition of this flexibility - indeed, a legislated solution would do much to enhance the reputation of corporations, especially if accompanied by a community education programme promoting the important role that corporations play in promoting positive social and environmental outcomes in Australia.

The EIA's rationale for a legislated solution is simple; while the current Corporations Act requirements are flexible enough to permit directors to have regard to the interests of specific classes of stakeholders and the broader community, there clearly remains an attitude among some corporate officers in Australia that the interests of the broader stakeholder community can and should be sacrificed in the interests of short-term shareholder returns. Indeed, corporate law and practice in Australia has contributed to a perception among some executives that they have a *responsibility* to maximise returns to shareholders through the externalisation of environmental and social costs created as a result of the firm's economic activity (for example, unsustainable environmental practices, or inequitable labour practices).

The externalisation of environmental and social costs by the corporate sector raises two important commercial concerns for investors, as well as concerns about social equity.

Firstly, a company's profitability is impacted by its management of natural and human resources and this will affect shareholder returns. Secondly, the EIA believes that traditional company analysis is inadequate for long-term investment decision making if it fails to take into account the sustainability of sources of natural and human capital. Lack of disclosure of these issues creates a market that is inadequately informed about a company's prospects. Point two is particularly relevant in Australia where approximately 45% of listed Australian shares are owned by long-term superannuation investors.

Legislative clarification that directors have the flexibility to take into account the interests of non-shareholder stakeholders should be welcomed by the business community. It will give comfort and possible legal protection to those directors who may, from time to time, wish to act in the long-term interests of the company at the expense of short-term profits. It may lessen opposition to corporate philanthropy, community business partnerships and other charitable works. It will help promote innovation in the creation and delivery of more sustainable services, products and manufacturing. It will help reduce allegations of 'greenwashing' as well as general community cynicism regarding the primacy of the profit motive. And finally it may reduce the risk of further government regulation due to a softening of community attitudes.

Question Two: Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporation decisions?

The EIA interprets this question in two parts. The first being an examination of whether directors should be required to take stakeholder issues into account. The answer to this aspect of the question is "yes". For all of the commercial and ethical reasons outlined in Question One, the EIA believes that a general positive requirement for directors to take account of specific stakeholders in corporate decision-making is both commercially prudent and socially responsible.

In particular, there are unique issues at stake in this regard for the superannuation investment community. Long-term investors now dominate Australia's financial marketplace with superannuation set to grow significantly in the coming decades. A growing number of superannuation investors recognise that profitability is dependant upon a company's capacity and skills in building long-term co-operative relationships with specific classes of stakeholders - in particular staff, customers, suppliers, the environment, shareholders and the host communities in which the company operates. These superannuation investors require assurance and disclosure that a company is aware of the risks and opportunities related to these issues and that decision-making is conducted in that framework.

In light of these considerations, the EIA also acknowledges that such a requirement may open avenues for a company to act in ways detrimental to shareholder value, and therefore adequate measures would need to be enforced to safeguard against self-interested or subjective decision-making.

The second part of the question is interpreted to ask whether a specific set or class of stakeholders should be identified within the Corporations Law. The answer to this aspect of the question would be "no". The EIA believes that directors should have the opportunity to identify their own stakeholders and the priority which will be assigned to them. This plurality of approach is also reflected in the varying SRI investment styles. These differing SRI investment styles include:

- traditional 'negative screening' companies will rule out investment in certain activities or sectors;
- 'positive screening' companies will seek to prioritise investment in certain activities or sectors;
- 'best of sector' investors may invest in all types of activities and sectors, but seek to promote corporate change by prioritising investment in the companies in each sector that score most highly on certain criteria; and
- Investors using an 'engagement overlay' approach might invest in all activities or sectors, but seek to promote change by using their influence as shareholders to engage directly with company boards or management.

In summary, the EIA supports changes to the Corporations Law that encourage companies to act in the interests of society and the environment , however our experience is that there is no 'correct' approach to corporate social responsibility. .

Question Three: Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and, if so, how?

Yes**.** The EIA strongly supports initiatives designed to encourage the adoption of socially and environmentally responsible business practices. We believe this will be best accomplished, in a manner beneficial to shareholders, companies and the community, through better disclosure to investors of the social and environmental consequences of business practices.

The EIA supports the strengthening and expansion of the existing ASX Principles of Good Corporate Governance and Best Practice Recommendations. It is noted that this has been recommended to the ASX Corporate Governance Council recently by the Federal government and the Federal Environment Minister, Ian Campbell. We further understand that the ASX Corporate Governance Council is undertaking work exploring how such a reporting regime might operate. Though the EIA is not a member of the ASX

Corporate Governance Council, we support its efforts as a robust forum through which the interests and concerns of both investors and companies can be addressed.

In the context of the ASX Corporate Governance disclosure regime, there is an opportunity to introduce stronger reporting and disclosure requirements of ASX listed companies through Principle 3 (“Promote ethical and responsible decision-making”), Principle 7 (“Recognise and manage risk”), and Principle 10 (“Recognise the legitimate interests of stakeholders”) of the ASX Principles of Good Corporate Governance.

In this respect, there are two pre-existing frameworks which are well placed to be adapted in order to augment the current ASX Guidelines:

1. The Global Reporting Initiative (GRI) which is the global standard for triple bottom-line reporting;

2. The Operating and Financial Review (OFR), a new mandatory disclosure regime proposed last year in the UK.

Question Four: Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

Yes, but the requirements of this reporting should not be legislatively prescribed.

The EIA supports the notion that individuals and institutions should make investment decisions fully informed of the environmental, social, and governance activities of investee companies. The ability to do so presupposes a certain level of disclosure regarding these matters.

There is no reason for listed companies to be exempt from the same sort of disclosure required of certain financial product issuers under Chapter 7 of the *Corporations Act 2001* (s1013D), This clause stipulates that financial product issuers must disclose the extent to which they take labour standards and environmental, social and ethical considerations into account in their investment decisions.

As noted above, in respect of ASX-listed companies, ASX Principles of Good Corporate Governance and Best Practice Recommendations already expect listed companies to “Recognise the legitimate interests of stakeholders” (Principle 10). Through the ASX Corporate Governance Council process, Australia has been able to develop a process through which the wider business and investor community can address concerns of corporate governance reporting, without imposing new or costly regulation. As well, Australia has been in the forefront of fostering sustainability reporting at home and internationally through involvement in the Global Reporting Initiative (GRI).

The EIA also notes that the Commonwealth Government has been promoting sustainability reporting through the Department of Environment and Heritage and more recently has been in dialogue with the ASX Corporate Governance Council on the matter of sustainability reporting for listed companies. The EIA also applauds the intent of the Energy Efficiency Opportunities Bill 2005, in that it will place new disclosure requirements on energy usage by the largest Australian companies.

Global Reporting Initiative (GRI)

While the EIA would support further advancement of these initiatives, care must be taken to ensure that disclosure is not enhanced in a piecemeal and uncoordinated fashion. The intended outcome should be the widespread availability of meaningful and consistent sustainability reporting by listed companies, such as is provided for in the world-leading Global Reporting Initiative.

The EIA is concerned that there has been debate within bureaucratic and business circles that there may be value in developing an 'Australian version' of sustainability reporting guidelines. The EIA strongly believes that Australian corporations need to develop sustainability practices that are consistent with the Global Reporting Initiative, in order to:

- promote comparability between sectors and companies;
- promote comparability between Australian and multi-national companies;
- promote greater understanding of reporting 'best practice' in an international context;
- assist investors both in Australia and overseas to properly account for long-term sustainability risks when making investment decisions; and
- assist corporations to communicate with key stakeholder groups about their sustainability performance in the clearest manner possible. The presence of a range of different reporting guidelines will only serve to confuse corporations seeking to communicate their progress in this area.

The EIA would emphasise that the GRI already has a strong and robust presence within Australia, with large Australian companies who undertake sustainability reporting doing so in the context of GRI. We would also note that the Global Reporting Initiative is a multi-stakeholder process and an independent institution whose mission is to develop and disseminate *globally applicable* Sustainability Reporting Guidelines. Representatives from Australian industry have played a key role developing 'Sector Supplements' to the Guidelines, in particular for the Financial Services sector.

Operating and Financial Review (OFR)

The EIA would suggest that the Committee consider the experience in the United Kingdom of the Operating and Financial Review (OFR) governed by the UK Accounting Standards Board (ASB). The legislation became mandatory in May 2005, but was unilaterally abolished by the Chancellor of the Exchequer in November 2005, an action now subject to legal challenge. The OFR is now under review with a view to possible reinstatement. It is described by the ASB as follows:

> "It is a principles-based standard, which in particular makes clear that the OFR shall reflect the directors' view of the business. The objective is to assist shareholders to assess the strategies adopted and the potential for those strategies to succeed. The information in the OFR will also be useful to a wide range of other users."

Introduction of the OFR followed seven years of white papers prepared by the Company Law Review Steering Committee under the title “Modernising Company Law”. This series of papers included recommendations around director fiduciary duty regarding corporate social responsibility, long-term reporting and disclosure time horizons, and stakeholder considerations.

Importantly, the resulting OFR provided investors with a long-term view of a company’s strategic risks, opportunities and uncertainties, “The ASB believes it important that the OFR shall have a forward-looking orientation, identifying those trends and factors relevant to the investors’ assessment of the current and future performance of the business and the progress towards the achievement of long-term business objectives.”

Particular issues addressed include:

- non-financial information about the business and its performance relevant to the judgement of past results and future performance;

- resources, principal risks and uncertainties which may affect the entity’s long-term value;

- environmental matters, including the impact of the business on the environment, on the entity’s employees and on social and community issues;

- significant relationships with stakeholders which are likely to directly or indirectly influence the performance of the business and its value; and

- the impact of society and communities affected by the entity’s activities.

The broad nature of the information supplied in the OFR is of direct relevance to mainstream financial analysts in gaining a wider and deeper view of the company’s true value, in the present and in the future. In particular, the lengthening of the time horizon and the broadening of issues which may affect the performance and value of a company complements the long-term investment time horizon of superannuation investors, an increasingly dominant source of global capital.

The UK OFR addresses two issues of significant importance in the quest to improve corporate environmental, social and governance performance – the ability for analysts to price non-financial or qualitative issues in this area, and the ability of the financial markets to assess corporate performance over the long-term in order to better match long term superannuation liabilities with long-term market returns.

The EIA supports moves which will strengthen these two objectives as addressed in the OFR reporting structure and believes that these objectives can be incorporated into the current ASX Corporate Governance Guidelines, thereby avoiding changes to the Corporations Act.

In respect to Question 3 above, the EIA’s recommendation to CAMAC would be to either:

1. Incorporate GRI reporting requirements into the ASX Corporate Governance Guidelines; or

2. Use the UK OFR as a basis from which to draw out elements which pertain to long-term reporting time horizons, the consideration of environmental, social,

ethical and governance issues, and the consideration of stakeholders and to incorporate these elements into Principles, 3, 7 and 10 of the ASX Corporate Governance Guidelines.

Section 299(1)(f) of the Corporations Act:

The EIA represents the interests of numerous investors who are interested in taking the environmental implications of their investments into account.

Section 299(1)(f) remains the only piece of Federal Legislation requiring companies to disclose some aspect of their environmental impacts to investors and the community.

Given the Government's recent focus on stressing the importance of good corporate behaviour in maximising positive outcomes for the environment (ref. Environment Australia's Public Environmental Reporting Guidelines), it seems at odds with community and regulatory sentiment both in Australia and overseas to repeal this piece of legislation.

Response to criticism that references to environmental issues are not relevant in the Corporations Act:

- such criticism is rooted in antiquated notions of the purpose of corporate law. Most corporate law was conceived in order to limit personal liability for collective corporate action, and was created at a time when sustainability of resources and the natural environment were simply not matters requiring consideration. This is no longer the case;

- environmental issues are integral to the existence, operation and profitability of every corporation, in any industry, anywhere in the world. Corporations use natural resources as productive inputs, consume energy generated from natural resources, produce physical products and packaging that inhabit the environment and emit waste substances into the environment;

- the importance of environmental risks and impacts to a company's bottom line has been demonstrated through numerous academic studies in recent times;

- this research has supported work by other elements of Government to encourage the recognition of the important role corporate sustainability plays in improving Australia's environmental performance;

- examples of recent public policy recognising this role include:
  * the inclusion of requirements for Australian fund managers to disclose their position on the environmental activities of their investments in the Financial Services Reform Act;
  * recent draft disclosure guidelines released by ASIC in support of the FSRA; extensive work done by Environment Australia over the last five years in developing guidelines for and publicising the importance of public environmental reporting by corporations; and
  * numerous examples of international governments mandating public environmental reporting by corporations; and

- the mandating of the disclosure of guidelines on investment managers relating to environmental issues contained in the Financial Services Reform Act necessitates the existence of reliable information sources against which managers can disclose. It seems illogical for the government to require fund managers to disclose on these issues, and then remove a requirement for corporations to provide such information.

Response to criticism that the section as it appears is 'vague':

The EIA would support this conclusion, and point to evidence that few corporations are interpreting the legislation in a consistent way, or reporting under this section in a manner that facilitates comparison between corporations' environmental performance.

However, a conclusion that legislation is vague presents an argument for its clarification, not its abolition.

To resolve this situation, the EIA would strongly recommend that the section be amended to include a requirement that corporations make disclosures under this heading in some sort of consistent way, perhaps in accordance with a sub-set of guidelines prepared by the UN-supported Global Reporting Initiative (GRI).

This would match with the approach that has been taken in this matter following the passing of the Financial Services Reform Act, where ASIC prepared a set of draft disclosure guidelines that have been presented to the finance industry for comment.

The EIA would be eager to participate in such a process, and given that the EIA's membership includes professional SRI research bodies, we would be in a strong position to do so.

In the absence of such a set of guidelines, disclosure benchmarks may be set by State governments, resulting in a confusion of regulations and extra stress upon corporations, as is the case at the moment with environmental regulations.

If you have any further questions or comments on this submission, please feel free to contact me on 02 8224 0314 or 0412 924 014.

Yours sincerely,

Louise O'Halloran
Executive Director

Law Council
OF AUSTRALIA

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 2967
SYDNEY NSW 2001

Dear Mr Kluver

Corporate Social Responsibility Discussion

This letter responds to the request for submissions in CAMAC's November 2005 Discussion Paper on Corporate Social Responsibility. The submission is made by the Corporations Committee (Committee) of the Business Law Section of the Law Council of Australia. Please note that the comments in this submission have been considered by the Executive of the Business Law Section, but not by the Law Council of Australia.

The Committee would first like to congratulate CAMAC on its coverage of the literature and issues relevant to an informed discussion of "corporate social responsibility". Given this excellent coverage, the Committee considers that its best contribution to this debate is a focussed expression of its views, rather than canvassing the broader range of possible opinion.

CAMAC terms of reference

In summary, the Committee's view is that the Corporations Act and the common law dealing with directors' duties allow directors appropriate flexibility to take into account a broad range of interests when they consider the interests of the company. The "principles" based approach reflected by the legislation and common law allows directors of solvent companies to take into account both necessary short term issues and the longer term, and to have regard to the circumstances of each company – its size, business and special impact on specific stakeholder groups.

These laws – which have remained the same in basic principle for over the whole of the past century and longer – have allowed corporate culture to adapt with and respond to changing societal expectations, new technologies, new business methods and changing concepts of who corporate "stakeholders" are.

The directors duties provisions of the Corporations Act and the common law do not provide inappropriate disincentives to directors who want to take account of stakeholder interests. However, actions taken by companies – for instance, representations made to the market about what conduct the company will or will not engage in – can constrain action. This is a necessary consequence of the interaction of a range of provisions of the Corporations Act, and that interaction should not be overridden by amendments to the laws dealing with directors duties.[1]

The Committee's philosophy most closely reflects the "commercial" view of corporate social responsibility set out in the Discussion Paper.

In relation to the issues raised in the CAMAC terms of reference, it is the Committee's view that:

1. **It is both unnecessary and undesirable to amend the Corporations Act to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions.**

   To the extent to which parliaments have considered that there are matters of public policy which override the rights of citizens – both individuals and corporations – they have enacted specific legislation to deal with the issue. Examples include environmental, occupational health and safety, industrial relations, consumer protection and trade practices laws. The Committee considers this to be the correct balance, and it is undesirable to include a generalised duty to stakeholder groups in the Corporations Act.

   An amendment to the Corporations Act which requires directors to have regard to the interests of stakeholder groups would be likely to:

   - *reduce flexibility*. By naming some stakeholders for special attention, questions are raised about the extent to which other interests must or may be taken into account.
   - *potentially increase the range of persons who can sue directors*. While it is likely that many of such cases would not be successful, the very fact that the law says an interest must be taken into account is likely to increase "opportunistic" litigation. This usually has a chilling effect on directors' willingness to take business risks (the original purpose for allowing limited liability companies) and may ultimately reduce the availability of insurance because insurers will bear the greater legal costs of more litigation, even if the litigation is ultimately not successful.
   - *reduce accountability*. This may seem counter-intuitive in light of the previous dot point, however, the current law provides a clear focus for directors' accountability. By broadening the interests which directors must take into account, it is likely also to provide a broader range of excuse for underperformance and give no guidance as to the circumstances in which one interest may or should weigh more heavily than another. ASIC, in its submission to the Parliamentary Joint Committee on Corporations and Financial Services, noted that broadening the scope of the interests that directors must take into account (or, pursuant to a "permission" provision, may take into account) may reduce effective enforcement.
   - *it is likely to increase "red tape"*. This is because directors will, in recording any decisions, seek to demonstrate that they have taken into account each interest which they are specifically required to take into account. This is likely to impose costs without countervailing benefit.

[1] Arguably what happened in the James Hardie case was this: having reconstructed the group and made representations to the market about the impact of that reconstruction on liability for asbestos related claims, the flexibility of directors may have been constrained from acting inconsistently with those representations without further shareholder approval. This is not a directors duties issue (although the public debate has framed it that way). Without the reconstruction of the James Hardie Group, the Committee considers that the directors could, consistently with their duties, have addressed asbestos liability issues.

- *be of uncertain scope.* It is unclear whether a mandatory provision would apply only to listed companies or to all companies. There is no clear case why the mandatory provision should apply only to listed companies, given that there are very substantial unlisted companies and other forms of business organisation. It is equally unclear why the mandatory provision should not apply to individuals or other forms of business organisation if it did apply with justification to small companies.
- *have a disincentive effect.* It is possible that a mandatory provision would operate as a disincentive to companies incorporating in Australia[2]. That would simply remove out of the reach of the Australian corporate regulator a range of companies doing business in Australia. That seems to be counter to good policy.

Under current law, directors are fiduciaries of other peoples' money. That policy setting is a fundamental building block on which Australia's capital markets are built, and nothing should be done to change that, because it is essential to investor confidence in investing money in Australian companies. Other important Government policy also implicitly relies on this – such as laws requiring and encouraging superannuation savings.

2. **The Corporations Act should not be revised 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.**

The Committee sees no legal need or benefit in providing a "permissive" provision and the Committee would not see it as an advance to the law. The Committee's concerns include:

- *interpretation.* If some stakeholder groups are named in the "permission", then the question is raised as to whether stakeholder groups who are not named may be taken into account or somehow have less priority. Further, listing stakeholder groups whose interests directors may take into account provides no guidance as to priority as between those groups or individuals in the groups (and it clearly cannot). As the law currently stands, directors are entitled to take into account a broad range of interests and to balance those interests according to circumstances.
- *reduces accountability.* This is discussed above.

The Committee notes that some other jurisdictions have included permissive provisions (eg the UK) however:

- they demonstrate the interpretation difficulty – because they do not include all classes of stakeholder.
- in the US, the provisions are usually limited to the takeover context.
- all of the overseas formulations relate to "the company" and do not address groups: ie, can a holding company act in the interests of stakeholders of subsidiary companies – the precise issue raised in the James Hardie case.

The Committee considers that the Corporations Act could usefully be amended to broaden the scope of section 1318(2) to allow courts to support decisions by directors. This provision would likely be most useful in cases of doubtful solvency. This is more fully argued in the AICD's submission to the Parliamentary Joint Committee on Corporations and Financial Services dated 30 September 2005.

[2] Note that as James Hardie NV is not incorporated in Australia a mandatory provision would have no impact on it.

3. **Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?**

The Committee considers that there are a range of factors already at work to encourage Australian companies to adopt socially and environmentally responsible practices, including:

- societal expectations. Companies are increasingly seeing the need to demonstrate good credentials in this area. This is particularly true of companies in areas of direct environmental impact (resources, energy) but it is clear that many companies also see it as an area in which to distinguish themselves.
- growing focus on risk management, especially reputation or "brand" risk. Because of changing societal expectations, companies are increasingly demonstrating their understanding of the need to manage reputation or "brand" risk. This involves increased monitoring and management of social, economic and environmental risks. This is being expressed in the greater number of companies publishing stand alone sustainability reports. Many more companies are giving prominence either in annual reports or on their website to corporate social responsibility issues whether called by that name or not.
- increased occasions for enhanced disclosure, for instance, reporting against the Recommendations of the ASX Corporate Governance Council. Greater disclosure by some companies raises the bar for others, and this is generally increasing the quality and scope of corporate reporting in this area.

The Committee considers that Government can most effectively encourage these sorts of developments by:

- demonstrating leadership in its own practices and the reporting of Government entities.
- support of particular industry or community initiatives. Landcare is a good example. Government encouragement of the banking industry's financial literacy initiatives is another.

4. **The Committee does not consider that the Corporations Act should require certain types of companies to report on the social and environmental impact of their activities.**

The Committee does not see the need for this. To the extent that any particular industry's public disclosure should be enhanced, that should be dealt with in legislation specific to that industry.

Further, in the observation of members of the Committee, many shareholders are finding the size and complexity of annual reports inaccessible. Care should be taken in imposing further information requirements, unless:

- the requirements are specific to the particular company. Generalised reporting requirements tend to lead to formulaic disclosure which is not informative or useful; and
- there is a clear call for them from the investment community.

If you wish us to expand on any of the points made above, please contact Kathleen Farrell (02) 9225 5305 or Greg Golding, Chair of the Corporations Committee ((02) 9296 2164.

Yours sincerely

Peter Webb
Secretary-General

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"CSR is a WMD"

Paper presented
by
John M. Green*
at

NSW Supreme Court & Law Society of NSW Conference

"Directors' Duties & Corporate Social Responsibility"

Banco Court, Supreme Court of NSW, Sydney
Monday August 21, 2006 at 2.30pm

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Tony Blair's government is beefing up directors' duties to make Corporate Social Responsibility the law in Britain. (Well, if you can't find one weapon of mass destruction, why not create your own?) In truth, this British development is wonderful… for Australian companies, though not British ones. (More on that later.)

Corporate Social Responsibility is an oozily seductive term, but don't let its politically-correct sugar-coating fool you, as Mr. Blair has been, yet again.

CSR is like the 'friend' some kid chats to on the internet but who turns out to be an axe-wielding pedophile. And just like that kid, business has been duped. In 2005, 88% of executives surveyed said CSR was 'central' or 'important' to their corporate decision-making.[1] There are two key reasons for this folly, the first bad and the other worse.

The first derives from the cunning fact that most of CSR's broad ambit claim is no more than good business practice, what we're doing already. So it's tempting to just shrug our padded corporate shoulders and pay lip service to the rest of it so we can get pats on the back and enjoy a quieter life. Tell that to the poor boiling frog. (If you drop a hapless frog into a pot of boiling water, it will leap out immediately. But, if you put it into a pot of cool water, and gradually heat it to boiling, the frog won't notice until it is too late.)

**John M. Green is a director, investor and writer.*
In his previous career he was an investment banker and, before that, a lawyer.
He is an occasional commentator on a variety of issues & is currently writing a book on how directors might better sniff out corporate crises before they happen.

The second reason businesspeople embrace CSR is we hate being hated. So spending money to popularise business —especially shareholders' money—is attractive. But it's also foolish. Trying to win friends for business through hugging trees or embracing CSR—much the same thing—is as smart as defending the family by asking your husband to sleep with Paris Hilton.

Worse, business's efforts to win *Australian Idol* are based on a false premise. No matter what even the best companies do, the public will stay archly sceptical. With remarkable consistency over the last 30 years, the annual *Roy Morgan* Survey of Professional Reputation has dumped business executives way down at the bottom of the barrel, even below lawyers. But thankfully, above politicians and journalists, though not by much[2].

The next Sunday lunch you turn up to, even if you're sporting a *Greenpeace* T-shirt and wearing environmentally-friendly sandals made out of braided palm fronds, the moment you let your guard down and admit to being a company director, the other guests will still screw up their noses at you as if you'd trodden in something unpleasant on the way in.

Luckily, when I go to BBQs these days, I don't have to reveal I'm a company director. I can just give my kaftan a self-deprecating tug and say I'm a writer.

Plain old 'Corporate Responsibility'

So, back to that boiling frog. If we dissect CSR into two parts, we expose its insidious trap. If you slice away the word 'Social', what you're left with is plain old Corporate Responsibility. It's a well-understood term that's been around a very long time; even before Bhopal though, scandalously, Union Carbide had trouble translating it into Hindi.

The problem with this word 'social' is it can justify almost anything as publicly desirable. "It's a weasel word," wrote lawyer Tom Bostock in the *Company Director* and quoting Friedrich Hayek. It sucks "out from the words it qualifies any real meaning, just as a weasel sucks out the contents of an egg."[3]

Almost 20 years ago, when I was still a lawyer, I coined the term "fuzzy law", advocating we stop writing black-letter laws in favour of laws based on general principles, laws a little fuzzy at the edges to encourage those affected to pull back into the safe zone rather than get too close to the edge and trip over the brink.

But this CSR stuff isn't just fuzzy at the edges, it's so mushy and fluffy, if you put your foot anywhere near it, it will suck you in and smother you like quicksand.

CSR's glib appeal is to encourage companies to look to wider purposes than just making money. It's also about corporate gift-giving.

CSR advocates criticise corporations for being solely devoted to making profits, letting all else go hang. They quote this, usually with a sneer, as a classic Milton Friedman dog-eat-dog formulation. But fortunately, it's become fashionable to check sources—we used to call it scholarship—and if, like me, you spend three minutes reading Friedman's famous 1970 article in *The New York Times*[4] you'll find what he actually said:

> "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition without deception or fraud."

Let me translate that into my own simpler prescription: *a corporation's fundamental responsibility is to increase its profits over time through worthy endeavour, free competition and honest practices*.

For most companies, telling the truth, selling reliable products for fair prices, and treating your people well are not virtues, they are duties.

How can it be a company's duty to condemn sick employees to hardship and penury just to save a few bucks? Try explaining that to your kids at the kitchen table.

What's really lurking behind CSR is the insidious and false assumption that CSR really stands for Crooks, Spivs or Retards… caricatures of rich white thieving bastards who yearn for nothing better than ripping off their customers with shoddy goods, screwing their employees with lousy pay and working conditions, all so they can spend their afternoons sinking back in their soft leather armchairs and puffing on fat cigars while they count their ill-gotten greenbacks. Maybe that was a fair generalisation once, but it isn't today. (For a start, you can't smoke anywhere, even if you wanted to.)

The true believers in CSR, when they're talking privately, want to reign in the excesses of capitalism. But their brand of CSR will reign in the wrong excesses, and in particular, what capitalism does best: creating wealth and lifting living standards.

It's just that the CSR zealots do see capitalism as a zero-sum, just as Karl Marx did. But happily, as we know, capitalism's earlier 19th and 20th century adversaries got it wrong. Sure, the rich got richer, as predicted, but the poor got richer, too.

Al Gore, a former US vice-president, complained earlier this year that "we are operating the Earth like it's a business in liquidation."[5] Spoken not just like a true believer, but a true president. (And he got so close!)

Some quick World Bank statistics about this world in supposed meltdown… In 1981, a shocking 40% of the planet's people lived in absolute poverty on less than $1 per day. But 20 years later, by 2001, that 40% had halved to 21%[6]. Amazing enough.

But contemplate that fall as actual numbers of people and it's even more startling. Despite around 2 billion more people cramming into the world, the actual number of people in absolute poverty didn't also balloon, as you might expect, it shrank. And not by a little, but by 400 million. 400 million real people escaped the clutches of absolute poverty at the same time as the world's population exploded.

And which people, where, have especially benefited from this? Those in our own neighbourhood: South Asia, East Asia & the Pacific, especially China. And what's driven that? Yes, globalisation and its chief financier and growth engine, the corporation.

Over the 15 years from 1990 to 2004, trade in East Asia has outstripped everywhere else in the world. And according to the World Bank, East Asia is the region where poverty has *decreased* the most. Some more numbers: over that 15-year period, merchandise imports into East Asia skyrocketed by over 5.5 times, but in Sub-Saharan Africa—where poverty *increased* the most—merchandise imports went up by only 2.5 times.[7] (And merchandise exports told a similar story.[8])

So, since capitalism's 21st century adversaries can't really argue with a straight face that the poor are getting poorer—at least in places where trade is encouraged—they wrap themselves inside the warm fake-fur of their CSR cloaks, and preach that the real problem today is how capitalism is making people too rich and it's not spending enough on what really matters, the environment and so on.

So they want the law to force corporates to redistribute all that fabulous wealth, before shareholders get their greedy mitts on it, so they can change the world for the better. (As if that wasn't what governments were for.)

But haven't these people been paying attention? Corporations *are* changing the world for the better, not because some law forces them or because we asked them nicely, but because it is a natural by-product of what they do best: increasing profits over time through worthy endeavour, free competition and honest practices.

Giving Back: Philanthropy

Occasionally, even smart businesspeople use loose language to tug our heartstrings to 'give something back'.

When they mean that we should give back personally, as individuals who have done well, then yes. Contributing to our community even beyond our jobs and taxes is something I know many of you already do. And if you don't, I encourage you to. And if you're at a loss where to spend your philanthropic dollars or your time, please ask me and I'll happily suggest some worthy projects and charities for you.

But hello! When it comes to the corporation, giving back is precisely what it does for its day job. Corporation are not free-riders, unjustly enriching themselves to the detriment of the community[9]. How corporations give back best is by being successful and thereby contributing to our economy and our society.

I believe virtue is giving away what's yours, not giving away what's someone else's. And corporate philanthropy, by definition, is giving away other people's money—what *The Economist* calls 'borrowed virtue'.[10] (It was no accident that the same journal's headline on Bill Gates' massive private gift to his foundation was *Billanthropy* and not *Excel*.)

I must make two admissions here. The first is that, as well as personal philanthropy, I also strongly believe in corporate philanthropy but, because it is other people's money, I say you need to satisfy two simple conditions first. My second admission is I'm a director of three not-for-profits: one gives corporate money away, and for the two others I happily go cap-in-hand seeking donations from individuals, foundations and, yes, corporates

So what are the two criteria for legitimately spending other people's money? First, that they knowingly consent to it. Some companies mandate gift-giving in their constitutions. Others have been doing it for years, openly referring to it in shareholder communications. As someone said, a firm should "no sooner make an anonymous donation to a charity than it would buy 30 seconds of silence on the radio."[11] Second, that you're donating to advance a legitimate corporate purpose. Not just to make directors and managers feel good, be invited to the right parties and save you spending your own money. Not as a salve to help justify the CEO's possibly excessive salary. Some examples are clear: A health fund giving money to educate the public about staying healthier and thus not becoming a bigger drag on your fund. An engineering firm giving scholarships to promote engineering studies to help show your employees you value education and self-improvement. A bank funding literacy and numeracy programs. A mining company bringing the arts to the remote local communities your workers live in.

But fundamentally, I believe corporations give back best by building businesses that over time can reliably pay increasing dividends to people, those saving for a home, a holiday, their kids' education or their retirement. They give back best by creating worthwhile jobs and fulfilling careers for those same people or their kids. They give back best by innovating products for better prices so those same families can afford them.

Sure, there are firms who try to squeeze out every last penny, who behave as anti-capitalists would expect, seeing it their duty to maximise profit in a zero-sum way. Well, sadly, there are people who enjoy eating other people too, but that doesn't mean we have to invite them to dinner.

Firms like this are few, and they're very short-sighted. Which is precisely why there are so few… because long-term, short-termism doesn't pay. If you run your business only for the short-term, it won't last into the long-term. And not many shareholders will trust you with their money for that.

How big is the problem?

Astonishingly, Australia has 1.4 million corporations[12]. That's almost as many corporations as Shane Warne has supposedly had lovers!

Now tell me… how many of our companies are run by bastards? Each of us could name a handful, probably the same handful. *Enron* was run by shysters who defrauded their investors, but if you travel to Houston as I did recently, *Enron's* name is plastered all over nearly every museum and art gallery. A great CSR practitioner, but tell that to the employees and retirees and other shareholders whose life savings were tied up in the company's now worthless shares. And *HIH*. Another philanthropic giant.

And, ah, yes, there's… but let's not get personal. Let's use ASIC statistics as an anonymous proxy, on the assumption that if a firm's reported for corporate misconduct, maybe they're also a bit grubby in their other practices. Well, last year ASIC received 10,752 reports of crime or misconduct[13] out of those 1.4 million companies. Even with the unlikely assumption that each complaint was about a different company, that's less than 1% of the corporate population. Is there a serious problem here?

Now take note of another statistic: a Hays Survey says 86% of workers just won't work for a firm with a bad employer reputation even if it offers them more pay than a firm of good reputation[14]. This is not rocket science. If a firm gets a name for treating people like washroom handtowels, ripping them off, using them and tossing them on the floor, of course that firm will have to offer more money to persuade people to go there.

And if you already work in such a place, either you'll quit or you'll be so bitter you'll take it out on customers, dismissing them back to the end of the line just because they filled out a form wrongly. And what do customers do if they keep getting grumpy service? They flee, too.

So if your workers don't give a toss and your customers desert you, it's obvious that your financial results and your shareholders will suffer. So much for being penny wise.

From how the CSR advocates talk, you’d expect that all the sacred texts of better business would be preaching the virtues of short-termism, wouldn’t you? But if you leaf through any popular business book written in the last generation, what you *won’t* find are preachers of the ‘maximise profits at all costs’ gospel. What you *will* find are proponents, if I can simplify it, of the mantra, ‘happy worker means happy customer means happy shareholder’. Yeah, yeah, I see some of you thinking, that’s just rhetoric and management school mumbo-jumbo, isn’t it?

Not at all. Substantive research shows that going nuts about this and not merely being a good employer, but striving to be a great employer, achieves something every capitalist aspires to: it rewards shareholders disproportionately to the costs. A *Hewitt Associates* book called *Leadership & Talent in Asia*[15]highlights some of this:

- A Vanderbilt University study showed firms with high staff engagement out-perform their competitor set on average as follows: 20% greater return on assets… 23% higher price-to-book ratios… nearly double the cumulative stock price returns.
- A Rutgers University study showed that high engagement firms got a 12% boost to their share prices, produced US$27,000 more sales per employee… generated US$3,800 more profit per employee and $18,600 more market value per employee.

You don’t need to be an enlightened corporation to want to do this. You’re actually a dumb corporation if you don’t.

Pure unadulterated corporate financial self-interest is best served by creating a firm so enticing that employees jump out of bed each day keen to rush in to serve customers who are lining up in droves at the door hungry for your products.

British Folly

Now why did I claim at the outset that, if Britain changes its law on directors’ duties to impose CSR, it would be good for Australia?

The proposed UK law says directors must promote the company’s success for the benefit of members as a whole but—and this is the important part—in doing this they must look to wider interests than those of shareholders, such as the interests of employees, the need to foster relationships with suppliers, customers and others—I repeat, others—the impact of the company’s operations on the environment, and so on.

Let’s take two examples.

Suppliers. How exactly do you have regard to “the need to foster the company’s business relationships with suppliers”? Let’s say you supply pencils to Selfridges, but the lead keeps breaking, so Selfridges strikes you off their supplier list. That’s hardly fostering a relationship with you, is it? Sounds like a fabulous idea for a law suit to me. Won’t happen, I hear you say? Just watch it.

The next example is the breathtaking requirement that directors must look to “fostering their company’s business relationship with ‘others’.”

Who wrote this drivel? The scriptwriters for *Lost*? *Lost* is one of my favourite TV shows. Does anyone else here watch *Lost*? Well, what happens in *Lost* is a plane mysteriously crashes on a weird Pacific Island midway between Sydney and L.A. An island where lots of really bad stuff happens. And on this island, there's a group of people called, you guessed it, the 'others'. And the thing is, neither the good guys in the show, nor you the viewer, has a clue about who these *others* are, why they're there, or even what they want.

Which is exactly what it'll be like for a British company director who now, by law, will have to worry about fostering a business relationship with the vague interests of some indeterminate *others*. Don't people who get elected to Parliament realize that people can go to prison for this rubbish? This isn't the rule of law, it's the fool of law.

Imagine waking up and unwrapping *News of the World* to read how *BMW* is suing *Virgin*. Not the German *BMW*, but a newly-formed NGO, *Britons to make Martians Welcome*. Richard Branson is to be pilloried, not because of his hurtfully youthful good looks, but because *Virgin* planes aren't Martian-friendly. But there aren't any Martians, you say? Not yet, says *BMW*. And, they burble on, do you really think they'll want to come to Earth if they're not guaranteed a lie-flat bed in coach?

What is especially horrifying about all this is that the CSR advocates might actually become right: that we will justifiably complain that directors aren't accountable to anybody. Because they'll be accountable to everybody and won't have a clue about how to balance the various interests they're supposed to be worrying about. If you don't know where to go, you just won't go anywhere.

What does all this mean for Australia?

The good news is Britain has unwittingly but graciously offered itself up to us as a guinea pig for a test trial. And the precautionary principle demands that it's in Australia's national interest to watch them try it out over there, all by their lonesome, from as far away as possible and for as long as possible.

Let me make a bold and serious prediction: if this British folly unfolds as I think it will, the returns of UK companies will fall and their cost of capital will rise. Investors will see UK firms as a riskier repository for their mobile capital. And if it's more costly for UK companies to raise capital, but relatively cheaper for Australian firms unburdened by CSR, eventually Australians will be able to buy British companies cheaper… except we won't want to.

Ladies and gentlemen, the Australian Parliamentary Joint Committee that's already examined CSR said, and both sides of politics were speaking, that we *shouldn't* try this here.[16] Exactly.

My submission to the ongoing CAMAC enquiry and the Hon. Mr Chris Pearce, the Parliamentary Secretary who asked CAMAC to look into this is: please, listen to your Australian co-legislators on this, take a cold shower and terminate your CAMAC enquiry.

Let Britain do all the work for us and in the meantime, Mr. Secretary, you can still be a hero to CSR advocates by saving a few trees by *not* producing ten thousand copies of some three-hundred page report.

And in the meantime, Australians can quietly and indecorously chuckle and smirk as we watch UK companies get dragged through years of litigious hell.

So, finally, my plea to the Australian government: Don't follow Britain onto this battlefield.

Endnotes to paper by John M Green, *"CSR is a WMD":*

[1] CAMAC (Corporations & Markets Advisory Committee) Discussion paper, *Corporate Social Responsibility*, November 2005. Page 1.

[2] Roy Morgan Research *Survey of professional ethics and honesty* conducted on November 17/18, 2005, http://www.roymorgan.com/news/polls/2005/3938/

[3] Tom Bostock, *Company Director*, December 2004

[4] *The New York Times Magazine*, September 13, 1970.

[5] "For People and Planet," by Al Gore & David Blood. *Wall Street Journal*, March 28, 2006

[6] *World Bank 2006 World Development Indicators*, http://devdata.worldbank.org/wdipdfs/table2_5.pdf ; *In Defence of Global Capitalism*, Johan Norberg, Centre for Independent Studies, 2005.

[7] *World Bank 2006 World Development Indicators, 1990-2004*, http://devdata.worldbank.org/wdi2006/contents/Section4.htm , table 4.5

[8] Ditto, table 4.5

[9] "Business Ethics Gone Wrong," by Alexei M. Marcoux, *Cato Policy Report*. May/June 2000

[10] *The Economist*, January 20th, 2005 in its Survey on CSR

[11] "Corporate Social responsibility—or good advertising?" by Andrew C. Coors & Wayne Winegarden. *Regulation*, Spring 2005

[12] ASIC Annual Report 2004-2005

[13] Ditto

[14] Hays Survey, http://www.hays.com.au/news/newsdesc.aspx?id=149

[15] Mick Bennett & Andrew Bell, *Hewitt Associates*, "Leadership & Talent in Asia," 2004, p.106 and 107

[16] Parliamentary Joint Committee on Corporations and Financial Services. "*Corporate Responsibility: Managing Risk and creating value*." June 2006.