



Australian Government
Corporations and Markets
Advisory Committee

CORPORATE SOCIAL RESPONSIBILITY

Discussion Paper

November
2005

Corporations and Markets **Advisory
Committee**

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On-line copies of this report are available at:

www.camac.gov.au

Bound copies of this report can be requested by:

email: camac@camac.gov.au

fax: (02) 9911 2955

phone: (02) 9911 2950

or by writing to:

Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

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Introduction

This section opens up the issue of the social responsibility of corporations in the context of questions that have been referred to the Advisory Committee for consideration and advice, identifies the aims of the paper and provides information for those who may wish to make submissions to the Advisory Committee.

0.1 The nub of the matter

Current interest in the social responsibility of corporations reflects in part the prominent role played by corporate business enterprises in contemporary society. The success of the corporate entity as a vehicle for harnessing capital and human, physical and intellectual resources to productive ends has resulted in it becoming the predominant form of private sector business organization and one that is frequently adopted for state-owned bodies as well. Companies large and small are involved in providing all manner of goods, services and related activities, locally and sometimes globally.

The prominent role of companies in the provision of goods and services, and the perceived reach of corporate activities and influence, have given rise to concerns about the impact of corporate conduct upon the broader community (including, for example, through environmental effects) and the transparency and accountability of the way in which corporations conduct their affairs. There may be underlying concerns too about possible divergence between the social responsibility of individuals acting on their own account and the collective responsibility of individuals acting in a corporate or other organizational environment.

There has been debate within Australia and elsewhere about the broader environmental and social impact of corporate activities and about the appropriate governance structures for taking these matters into account. Current interest in the subject is reflected in the efforts of companies themselves to explain better their own practices and contributions to society, in calls by community groups and others for improved practices, more information or more regulation, in the

growth of self-styled ethical investment funds and in legislative measures to regulate ever more aspects of corporate behaviour.

Issues concerning the social responsibility of corporations need to be considered against the background of the corporate governance debate and changes in the governance framework in recent years. The thrust of most legislative efforts has been to strengthen the accountability of directors to shareholders through measures including enhanced disclosure and improved financial reporting and auditing. Careful consideration needs to be given to whether any proposals for further change will strengthen, not impair, the accountability of corporations and those who conduct their affairs.

Within this broad context, the Corporations and Markets Advisory Committee (the Advisory Committee) has been asked to consider the interests directors may or should take into account in corporate decision-making, whether, or how, corporations should report on the social and environmental impact of their conduct and whether further initiatives are needed to encourage companies to adopt socially and environmentally responsible business practices.

0.2 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?

0.3 Purpose of the paper

The paper reviews the questions raised in the terms of reference in the context of the current framework for the governance of companies, developments in corporate practice and debate about the responsibilities of companies. Reference is made to discussion and developments at the international as well as local level. The literature on the topic of corporate social responsibility is vast and is drawn from a variety of disciplines and perspectives, including, but not confined to, corporate law. This paper reflects the Advisory Committee's own research and preliminary consideration of the issues. It seeks to identify some key themes and issues. Its purpose is to provide information, draw out issues and stimulate discussion, as part of the Advisory Committee's public consultation process.

0.4 Entities other than private sector corporations

The debate about corporate social responsibility has largely centred on the conduct of multinational and other large private sector companies. However, similar issues would also arise for other entities, such as public sector bodies, smaller proprietary companies, partnerships, trusts and sole traders, where their conduct and activities have material environmental or other societal impacts.

0.5 Parallel inquiries

Separate from the Advisory Committee's inquiry, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in June 2005 commenced an inquiry into corporate social responsibility and called for submissions. In pursuing its own inquiry, the Advisory Committee will seek to have regard to all available information and views relevant to its terms of reference. While it has not, in the preparation of this paper, had regard to proposals for change in submissions that have been made to the PJC, it will take account of relevant parts of those submissions in its further consideration.

0.6 Request for submissions

The Advisory Committee invites submissions on any aspect of the matters covered in the terms of reference and in this paper, including the issues set out throughout this paper at sections 1.5, 2.7, 3.4, 4.8, and 5.7.

Respondents to this discussion paper who have already made a submission to the PJC may wish, as a matter of convenience, to incorporate that earlier submission by reference, rather than restate it, together with any additional matters they may wish to put forward.

Respondents to this discussion paper are requested, when putting forward any proposal for change, to indicate how they would see the proposal being implemented and working in practice.

Please send your submission, in Word format, to:

john.kluver@camac.gov.au

If you have any queries, please phone (02) 9911 2950.

Please forward your submissions by **Friday 24 February 2006**.

All submissions, unless marked confidential, will be published on the Advisory Committee's website www.camac.gov.au.

0.7 Functions and membership of the Advisory Committee

Advisory Committee

The Advisory Committee is constituted under Part 9 of the *Australian Securities and Investments Commission Act 2001*. Its functions under s 148 of that Act include, on its own initiative or when requested by the Treasurer or the Parliamentary Secretary to the Treasurer, to provide advice to the Government on any aspect of corporate or financial markets law reform or any proposal to improve the efficiency of the financial markets.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The members of the Advisory Committee as at the date of publication of this paper are:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne
- Zelinda Bafile—General Counsel and Company Secretary, Home Building Society Ltd, Perth
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Berna Collier—Commissioner, Australian Securities and Investments Commission (alternate to Jeffrey Lucy, Chairman, ASIC)
- Louise McBride—Director, Grant Samuel Corporate Finance, Sydney
- Alice McCleary—Company Director, Adelaide

- Marian Micalizzi—Chartered Accountant, Brisbane
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson Waldron, Sydney
- Greg Vickery AM—Chairman and Partner, Deacons, Brisbane
- Nerolie Withnall—Company Director, Brisbane.

Legal Committee

The function of the Legal Committee is to provide expert legal analysis, assessment and advice to the Advisory Committee in relation to such matters as are referred to it by the Advisory Committee.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee as at the date of publication of this paper are:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Julie Abramson—General Manager, National Australia Bank, Melbourne
- Ashley Black—Partner, Mallesons Stephen Jaques, Sydney
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Brett Heading—Partner, McCullough Robertson, Brisbane
- Jennifer Hill—Professor of Law, University of Sydney
- Francis Landels—former Chief Legal Counsel, Wesfarmers Ltd, Perth
- Duncan Maclean—Special Counsel, Minter Ellison, Perth

- Laurie Shervington—Partner, Minter Ellison, Perth
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gary Watts—Partner, Fisher Jeffries, Adelaide
- Elizabeth Whitelaw—Partner, Minter Ellison, Canberra.

Executive

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

The Advisory Committee acknowledges the assistance provided to the Executive by Liz Lange of the Sustainability Consulting Group in preparing this paper.

1 The issue of corporate social responsibility

This chapter examines the emergence of corporate social responsibility as an issue, outlines various approaches to responsible corporate conduct in practice and indicates some areas of current debate, including the role of triple bottom line or sustainability reporting in promoting transparency and accountability for the environmental and social impact of corporate conduct.

1.1 The concept

Corporate social responsibility, while not a new issue, has been developing for some time as a significant theme in the global as well as local business community. Whereas 54% of executives in one global survey in 2000 said that this notion was ‘central’ or ‘important’ to their corporate decision-making, that figure had grown by 2005 to 88% of executives surveyed. Likewise, whereas 34% of professional investors in that same global survey in 2000 said that corporate social responsibility was ‘central’ or ‘important’ to their investment decisions, that figure had risen by 2005 to 81%.¹ Also, it has been suggested that perceptions of corporate social responsibility being more in the nature of corporate public relations or marketing rhetoric than substance may be diminishing.²

¹ Economist Intelligence Unit, *The importance of corporate social responsibility* (2005) at 5.

There can be a lag between perceiving the significance of the notion of corporate social responsibility and implementing measures in response. For instance, a survey in 2002, reported in Ernst & Young, *Corporate Social Responsibility of global companies* (2002), found that only 19% of companies surveyed believed that their social responsibility agenda had been effectively promoted and understood throughout the organization and only 9% of companies had identified and prioritised key risks and opportunities associated with their social responsibility strategy.

² The Economist Intelligence Unit observed that:

While there is an increasing recognition and acknowledgement of corporate social responsibility (or comparable notions such as ‘corporate citizenship’ or ‘corporate social accountability’) as an issue, the term does not have a precise or fixed meaning. Some descriptions focus on compliance with the spirit as well as the letter of applicable laws regulating corporate conduct, while other descriptions concentrate on the societal impacts of corporate activities (sometimes encapsulated in the notion of sustainability) on groups (usually referred to as stakeholders) including, but extending beyond, shareholders.³ These societal effects, going beyond the physical or social goods or services provided by companies and returns to shareholders, are sometimes subdivided into environmental, social and economic impacts.⁴

Until recently, board members often regarded corporate responsibility as a piece of rhetoric intended to placate environmentalists and human rights campaigners. But now, companies are beginning to regard corporate responsibility as a normal facet of business and are thinking about ways to develop internal structures and processes that will emphasise it more heavily (id at 3).

³ SustainAbility (a UK organization) describes corporate social responsibility as ‘a business approach embodying open and transparent business practices, ethical behaviour, respect for stakeholders and a commitment to add economic, social and environmental value’.

The European Union (EU) Green Paper *Promoting a European framework for Corporate Social Responsibility* (2001) described corporate social responsibility as ‘a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis’.

The International Finance Corporation (IFC) refers to corporate social responsibility as ‘the commitment of businesses to contribute to sustainable economic development by working with their employees, their families, the local community and society at large to improve their lives in ways which are good for business and for development’.

The Certified General Accountants Association of Canada paper, *Measuring Up: A Study on Corporate Sustainability Reporting in Canada* (2005) at 20 describes corporate social responsibility as ‘a company’s commitment to operating in an economically, socially, and environmentally sustainable manner, while recognising the interests of its stakeholders, including investors, customers, employees, business partners, local communities, the environment, and society at large’.

⁴ For instance, according to the *Global Reporting Initiative (GRI) 2002 Sustainability Reporting Guidelines*:

- *environmental impact* means an organization’s impact on living and non-living natural systems, including eco-systems, land, air and water. Examples include energy use and greenhouse gas emissions

At this stage of its consideration, the Advisory Committee does not propose a particular definition of corporate social responsibility that may limit its review. In essence, the focus 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.

In this paper, the term ‘social’ is used to include economic matters referred to in some descriptions. Only in the context of discussing triple bottom line reporting, a form of reporting with a broader perspective than traditional financial reporting, will this paper specifically refer to a division between environmental, social and economic impact.

This paper does not deal with issues related to some aspects of corporate decision-making, such as conflicts of interest affecting decision makers, improper use by them of corporate information or position, or other forms of self-dealing. While these matters can affect community perceptions of commercial morality, they are a discrete area of corporate governance, with their own fiduciary and regulatory requirements.⁵

1.2 History

Corporate social responsibility first emerged as an issue in the USA.⁶ More recently, international bodies such as the United Nations (UN) and the Organisation for Economic Co-operation and Development (OECD) have developed guidelines and other policy documents as

-
- *social impact* means an organization’s impact on the social system within which it operates. This includes labour practices, human rights and other social issues
 - *economic impact* means an organization’s impact both direct and indirect on the economic resources of its stakeholders and on economic systems at the local, national and global levels.

⁵ Some aspects of these internal corporate governance matters are dealt with in the Advisory Committee discussion paper, *Corporate duties below board level* (May 2005) (available at www.camac.gov.au).

⁶ For a useful overview of the history of the corporate social responsibility concept in the United States, see H Wells, ‘The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century’ (2002) *51 Kansas Law Review* 77, D Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution, 2005).

models of appropriate corporate behaviour, particularly for multinational or other large corporations. In addition, the European Union (EU) has issued a corporate reporting directive relevant to corporate social responsibility, while some of its member States have undertaken further initiatives.

1.2.1 USA

Much of the debate about the social responsibilities of corporations has centred on the merits of what has been described as the ‘shareholder primacy’ approach to corporate decision-making, with its focus on maximising shareholder wealth.

An early leading case was *Dodge v Ford Motor Co* 170 NW 668 (1919), where the Michigan Supreme Court considered a shareholder’s claim that the Ford Motor Co be compelled to pay a dividend, contrary to the decision of the Ford board to plough back all profits into expanding the business and increasing the number of employees. According to the board, this ‘no dividend’ policy would have a broader social benefit, as it would ‘spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes’. In upholding the shareholder’s claim, the court articulated the shareholder primacy principle as follows:

A business corporation is organized and carried on primarily for the profit of the [shareholders]. The powers of the directors are to be employed for that end. The discretion of the directors is to be exercised in the choice of a means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits amongst [shareholders] in order to devote them to other purposes (at 684).

Subsequently, in a famous debate in the 1930s, Professor Berle, in supporting the ‘shareholder primacy’ view, argued that the powers and duties given to directors of a corporation should be exercisable only for the benefit of, and to maximise profits for, the shareholders, given that these are the investors who have put their capital at risk, and that the directors should be answerable only to them.⁷ Any attempt to broaden these responsibilities to persons other than

⁷ A Berle, ‘Corporate Powers as Powers in Trust’ (1931) 44 *Harvard Law Review* 1049, A Berle, ‘For Whom Corporate Managers Are Trustees: A Note’ (1932) 45 *Harvard Law Review* 1365.

shareholders may result in directors having no legally enforceable responsibilities to anyone.⁸

In reply, Professor Dodd argued that larger corporations owe duties to the broader community, not just shareholders, and that directors should have greater leeway to take non-shareholder interests into account.⁹ An argument advanced to support this broader view was that, as the act of incorporation confers significant privileges (including perpetual succession and limited liability), society is entitled to expect that a corporation will act in the general public interest, not just out of self-interest.

The debate on whether companies have responsibilities beyond their role in producing goods and services and returns to shareholders resumed in the 1950s, driven in part by arguments that larger US corporations had disproportionate economic, political and social power and influence, which carried with it social obligations to affected groups beyond shareholders.¹⁰ That debate continued into the 1960s and the 1970s, focusing primarily on what should be the appropriate role, and responsibilities, of larger corporations in relation to consumer protection, environmental degradation, minority rights and urban renewal.¹¹ Some proponents of the view that corporations have broader social responsibilities began to make use of shareholder proposal laws in attempts to influence corporate

⁸ According to Professor Berle (45 *Harvard Law Review* 1365 at 1367):

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.

⁹ EM Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145 at 1162.

¹⁰ Relevant famous authors from the period include Vance Packard, *The Hidden Persuaders* (1957), John Kenneth Galbraith, *The Affluent Society* (1958) and C Wright Mills, *The Power Elite* (1959).

The view that corporations have some form of broader obligation was to some extent reflected in *AP Smith Mfg Co v Barlow* 98 A.2d 581 (N.J. 1953), a leading US decision approving corporations making charitable donations, in which the Court observed:

Just as the conditions prevailing when corporations were originally created required that they serve public as well as private interests, modern conditions require that corporations acknowledge and discharge social as well as private responsibilities (at 586).

¹¹ The notion of consumer activism can be traced back to Ralph Nader, *Unsafe at any Speed* (1965). Also, A Berle and G Means, *The Modern Corporation and Private Property* (1967) analysed the social and environmental impact of larger US corporations.

policy or conduct.¹² A contrary position was that the role of the corporation is to create economic value for its shareholders through its business practices, which in turn would have wider economic benefits. To impose some form of wider social agenda on a corporation was contrary to the best interests of shareholders.¹³

From the early 1980s into the 1990s, at a time when corporate raiders were active and hostile takeovers frequent, the corporate responsibility debate in the USA focused on the social impact of these takeovers. US state-based law required a board of directors to act in the best interests of the corporation, which, in the context of a takeover bid, was seen as imposing pressure on target boards to support that bid if it would ultimately benefit shareholders, even if it would also result in retrenching employees, closing or relocating

¹² Under US SEC rule 14a-8, a shareholder of a public corporation can in certain circumstances require that a proposal be included on the agenda of the corporation's annual general meeting and be distributed to all shareholders before that meeting. Various shareholders used this rule to put up and publicise various social and other proposals for consideration at that meeting.

Use of this provision has not diminished. For instance, 'in the 2002 proxy season, shareholder activists in the United States filed nearly three times as many climate change resolutions as were filed during any previous year of an 8-year campaign. Between 1994 and 2002, 62 shareholder resolutions on global warming issues were filed with the SEC, and 26 of them came to votes': E Hancock, 'Corporate risk of liability for global climate change and the SEC disclosure dilemma' (2005) 17 *Georgetown International Environmental Law Review* 233 at 249.

Compare the *Canada Business Corporations Act*, which was amended in June 2001 to delete a provision that permitted corporations to reject attempts by shareholders to propose shareholder resolutions that were 'primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes'.

¹³ For instance, M Friedman in *Capitalism and Freedom* (University of Chicago Press, 1962) and in 'The social responsibility of business is to increase its profits' *New York Times Magazine* 13 September 1970 argued that the only social responsibility of business was to use its resources and engage in activities designed to increase its profits and the only restriction in so doing was that business must engage in open and free competition without deception or fraud. He also questioned whether corporations can or should be involved in making public policy decisions, based on environmental, social or other ethical considerations, given that corporations are designed principally to generate wealth and profit.

factories or engaging in other rationalisations that might detrimentally affect local communities.¹⁴

In response, a majority of states in the USA adopted, and still retain, 'corporate constituency' statutes, to permit directors to broaden the groups or constituencies that they may take into account in corporate decision-making. These statutes were intended primarily to assist target boards to resist hostile takeover bids, though many were not confined in their terms to matters involving a change of corporate control. Typically, they permit a board, in considering the best interests of the corporation, to take into account the effect of any action by the board on employees, suppliers and customers of the corporation, or communities in which offices or other establishments of the corporation are located.¹⁵

A central theme of current debate in the USA is non-financial risk management and disclosure, including whether current disclosure rules are adequate to require larger corporations to provide sufficient publicly available information, for the benefit of investors and other interested parties, regarding their policies and practices in relation to the environmental and social impact of their operations.¹⁶

¹⁴ For instance, in *Revlon, Inc v McAndrews & Forbes Holdings, Inc* 506 A.2d 173 (Del. 1986), the Delaware Supreme Court said that the board of a takeover target could take into account non-shareholder interests in considering a takeover bid only where a 'rationally related benefit' would accrue to shareholders. This decision significantly qualified the previous Delaware Supreme Court decision in *Unocal Corp. v Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985) that the board of a target company could take into account the impact of a takeover bid on 'constituencies' other than shareholders, including employees and customers, in determining their response to that bid.

¹⁵ The Pennsylvania Act of December 23, 1983 was the first corporate constituency statute. A typical statute is that of Illinois, which provides that:
in discharging the duties of their respective positions, the board of directors, committees of the board, individual directors and individual officers may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors.

¹⁶ C Williams, 'The Securities and Exchange Commission and corporate social transparency' (1999) 112 *Harvard Law Review* 1197, C Williams, 'Symposium: Corporations Theory and Corporate Governance Law. Corporate Social Responsibility in an Era of Economic Globalization' (2002) 35 *University of California Davis Law Review* 705.

1.2.2 International

Beginning in the 1970s, and growing particularly in the last decade, there has developed an array of international codes, norms, principles, guidelines, standards and indices dealing with responsible corporate conduct.¹⁷ This section summarises some of the key documents and indices.

Normative standards

These voluntary standards provide guidance to corporations on what constitutes socially responsible conduct. The principal ones are:

- *OECD Guidelines for multinational enterprises* (1976, revised in 2000), being voluntary principles and standards for responsible business conduct by multinational enterprises operating in or from OECD member countries, including Australia. The guidelines aim to ‘encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress and to minimise the difficulties to which their various operations may give rise’.¹⁸ They cover major areas of business conduct, including employment and industrial relations, human rights, environmental protection, combating bribery, consumer interests and competition
- *UN Global Compact* (2000), under which companies may voluntarily commit themselves to various principles to guide

¹⁷ K McKague & W Cragg, *Compendium of Ethics Codes and Instruments of Corporate Responsibility* (September 2005) contains a comprehensive collection of relevant codes, guidelines and other instruments of corporate responsibility in global markets. The Compendium contains the full text or the most important sections of major codes, briefly introduced where necessary and accompanied by contact details for further information.

R Goel & W Cragg, *Guide to instruments of corporate responsibility* (October 2005) also contains an overview of leading international corporate responsibility instruments, principles, codes and standards.

¹⁸ p 17, para 10.

their conduct in the areas of human rights, labour standards, the environment and anti-corruption¹⁹

- UN *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy* (1977, revised in 2000), which provides guidelines on the responsibilities of business and government in the area of labour and employment
- UN *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003), intended to be a comprehensive set of international human rights norms specifically applicable to transnational corporations and other businesses. The Norms consolidate a range of human rights found in UN and other multilateral instruments and voluntary codes. They establish voluntary business performance standards in relation to them.²⁰

Management systems and certification schemes

Various frameworks or systems have been developed that corporations may use if they choose to adopt particular normative standards. The principal ones are:

- *International Organization for Standardization (ISO) 14000 series*, dealing with environmental management
- *Social Accountability 8000 (SA8000)*, relevant to labour standards in developing countries

¹⁹ The current principles of the Compact derive from the Universal Declaration of Human Rights (1948), the Rio Declaration on Environment and Development (1992), the International Labour Organization's Declaration on Fundamental Principles and Rights at Work (1998) and the United Nations Convention against Corruption (2003).

²⁰ These non-binding norms, which include employee, consumer protection and environmental standards, are based on the view, as expressed in the 2003 Norms, that:

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.

- *AccountAbility 1000 (AA1000) Series*, which guides corporations in establishing a process for engaging with their stakeholders
- *Sigma Guidelines*, being guiding principles for sustainability and a management framework to integrate sustainability into corporate decision-making.

The ISO is developing the ISO 26000 Guideline for Social Responsibility, which is expected to be released in 2008.

Accountability and reporting frameworks

A generally-recognised and adopted voluntary reporting standard is the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines 2002.²¹

The GRI guidelines are supported by other standards dealing with the independent verification of reports based on the GRI, such as:

- *AA1000 Assurance Standard*²²
- *International Standard on Assurance Engagements (ISAE 3000)*, issued by the International Auditing and Accounting Standards Board.²³

²¹ The GRI is an Amsterdam-based independent institution, which includes representatives from business, accountancy, investment, environmental, human rights, research and labour organizations from around the world. Begun in 1997, GRI became independent in 2002, and is an official collaborating centre of the United Nations Environment Programme (UNEP).

²² The *AA1000 Series Assurance Standard*, developed by the UK-based organization AccountAbility, deals with the process of independent verification of triple bottom line reports. It provides an audit/assessment framework and protocol designed to complement the GRI Guidelines and other standardised or company-specific approaches to disclosure.

²³ This standard, applicable from 1 January 2005, establishes basic principles and essential procedures for undertaking assurance engagements other than audits or reviews of historical financial information.

Rating indices

A range of indices track the performance of companies in corporate sustainability and related matters. The main ones are:

- *Dow Jones Sustainability Index*, comprising the top 200 global companies that satisfy certain criteria on environmental protection, sustainability, social issues, stakeholder relations and human rights
- *FTSE4Good Index Series* (a subset of the FTSE share trading indices), which measures the performance of companies that meet globally recognised corporate responsibility standards.²⁴

1.2.3 European Union

The European Union describes corporate social responsibility as ‘a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis’.²⁵ This principle was first formally adopted in the EU ‘Lisbon Strategy’ (2000) and has been applied in subsequent EU policy instruments.²⁶ 2005 was designated the ‘Year of Corporate Social Responsibility’ by the EU.

European States have adopted a range of national policies to promote socially responsible conduct by corporations, including new rules requiring larger corporations to disclose information about the environmental and other social impacts of their activities.

France and the UK have established Ministries of Corporate Social Responsibility to promote socially responsible corporate practices.

²⁴ The FTSE Group is an independent company that originated as a joint venture between the Financial Times and the London Stock Exchange.

²⁵ European Commission, *Corporate Social Responsibility: A Business Contribution to Sustainable Development* (July 2002).

²⁶ See, for instance, the Green Paper *Promoting a European framework for Corporate Social Responsibility* (2001) and *The Commission Communication concerning Corporate Social Responsibility: A Business Contribution to Sustainable Development* (July 2002). In the latter communication, the Commission noted (at 5) ‘the growing perception among enterprises that sustainable business success and shareholder value cannot be achieved solely through maximising short-term profits, but instead through market-oriented yet responsible behaviour’. In this context, the Commission noted the strong role the socially responsible investment and other financial markets had to play in contributing to the promotion of corporate social responsibility.

1.2.4 Australia

Aspects of corporate social responsibility have been discussed in Australia over some decades.²⁷ Relevant questions were considered by the Senate Standing Committee on Legal and Constitutional Affairs in its report *Company Directors' Duties* (November 1989). The issue continued to be discussed during the 1990s²⁸ and re-emerged in the context of the discussion of the James Hardie matter and the *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (September 2004) (the Jackson report).²⁹

1.3 Different approaches

There is a range of views about what social responsibility entails for companies in practice, including:

- the compliance, the philanthropic and the commercial approaches, each being directly or indirectly linked to corporate benefit (which includes avoidance of detriment), and

²⁷ For instance, R Baxt in 'The Duties of Directors of Public Companies—The Realities of Commercial Life, The Contradictions of The Law, and the Need for Reform' (1976) 4 *Australian Business Law Review* 289 at 301 observed that the realities of the modern company are that directors, in their corporate decision-making, will take into account 'a multitude of interests—the interests of creditors, the financial position of the company ... the claims of employees ... the needs of the economy ... and the various obligations of the company in a social context'. See also Lord Wedderburn, 'Southey Memorial Lecture 1984: The Social Responsibility of Companies' (1985) 15 *Melbourne University Law Review* 4.

²⁸ See, for instance, J Tolmie, 'Corporate Social Responsibility' (1992) 15(1) *University of New South Wales Law Journal* 268, B McCabe, 'Are corporations socially responsible? Is corporate social responsibility desirable?' (1992) 4 *Bond Law Review* 1, A Corfield, 'The Stakeholder Theory and its Future in Australian Corporate Governance: A Preliminary Analysis' (1998) 10 *Bond Law Review* 213.

²⁹ Among other matters raised in the Jackson report were tort liability within corporate groups and 'long-tail liabilities'. The Advisory Committee referred to this question of tort liability in Chapter 4 of its report *Corporate Groups* (June 2000) (available at www.camac.gov.au), which predated the issue that arose in the James Hardie matter and was considered in the Jackson report. The Advisory Committee received a reference in October 2005 to review long-tail liabilities. Further details can be found at www.camac.gov.au.

- ethics-based and altruistic approaches, which are not necessarily linked to corporate benefit.

These approaches are not necessarily mutually exclusive.

1.3.1 Compliance approach

The compliance approach to social responsibility emphasises that, while companies are obliged to comply with the letter of the law (regardless of the commercial consequences), they may benefit from complying with the ‘spirit’ of the law, as it may be perceived in the general community.

Letter of the law

Companies must comply with applicable laws that regulate their internal conduct and their external dealings. Directors should not intentionally flout laws or treat some breaches merely as part of the costs of business simply because they estimate that this is cheaper than the costs of full compliance.³⁰ Likewise, internal corporate policies should not be used to justify breaches of the law.³¹

The American Law Institute (ALI)³² *Principles of Corporate Governance* contain model provisions for US corporate law. That model includes clause 2.01(b)(1), which reflects the letter of the law compliance approach:

Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its

³⁰ S Bielefeld, S Higginson, J Jackson & A Ricketts, ‘Directors’ duties to the company and minority shareholder environmental activism’ (2004) 23 *Company and Securities Law Journal* 28 at 40 provide the following rather extreme example that nevertheless makes the point:

at law, the directors of a company must ensure it obeys the statute requiring the corporation to insert a \$50 million filter on the factory’s smokestack, and cannot merely choose to pay the \$25 fine for non compliance.

³¹ Compare *Independent Commission against Corruption v Cornwall* (1993) 116 ALR 97, which held that any conflict between a code of conduct and obedience to the law must be resolved in favour of the law.

³² The American Law Institute was established in February 1923 at a meeting in Washington DC of representative judges, lawyers and law teachers. Since then, the ALI has undertaken a range of projects, including the Corporate Governance Project.

business, is obliged, to the same extent as a natural person, to act within the boundaries set by law.³³

The ALI Commentary explains the reasoning behind that clause:

It is sometimes maintained that whether a corporation should adhere to a given legal rule may properly depend on a kind of cost-benefit analysis, in which probable corporate gains are weighed against either probable social costs, measured by the dollar liability imposed for engaging in such conduct, or probable corporate losses, measured by potential dollar liability discounted for likelihood of detection. Section 2.01 does not adopt this position ... The corporation is obliged to act within the boundaries set by law to the same extent as a natural person—no less, but no more.³⁴

Spirit of the law

Companies are not obliged to go beyond compliance with the letter of the law. However, the adoption of business practices and internal standards that promote full compliance with what is generally perceived to be the ‘spirit’ as well as the ‘letter’ of legal obligations may signify a well-managed and responsible company. This policy may also help safeguard the company against various reputational and other risks to longer term shareholder value arising from perceived attempts to flout the real intent of the law.

The report by SustainAbility and others, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability* (2005), refers to the international trend towards a form of ‘moral liability’ for companies that breach the spirit of the law and its potential to affect adversely businesses that are still focusing exclusively on strict legal compliance:

There is a growing concern that companies (and others) should conform to the spirit as well as to the letter of the law. In other words, technical compliance may no longer be an adequate defence against social and environmental activists in the court of public opinion and even in the courts of law. Technical innocence or escaping accountability through legal expertise and subtle

³³ American Law Institute, *Principles of Corporate Governance: Analysis and recommendations* vol 1 (American Law Institute Publishers, 1994) at 55.

³⁴ id at 60–61.

arguments on points of legal interpretation and precedent are becoming increasingly unacceptable in a society that expects real world performance and behaviour standards.

Rather:

Negative attention by the media or activists can cause a company to be condemned in the court of public opinion—judged ‘morally liable’ for societal damages—often very quickly, and without any judicial controls or procedures to ensure a fair and balanced hearing.

The report also noted that this form of ‘moral liability’ can ‘affect a company commercially before it is felt as a trading or balance sheet liability, either by accounting regulation or in law’.

1.3.2 Philanthropic approach

The philanthropic approach to social responsibility involves companies giving to the community, in a variety of financial or other ways above and beyond their primary business activities, provided there is some direct or indirect benefit to the company in so doing.

Philanthropy in this context may go beyond corporate donations to charitable causes. It can extend to corporate sponsorship, creation of benevolent corporate foundations, direct involvement with particular communities in social projects, staff volunteering for these projects and ‘workplace giving’ programs. It may also involve companies and not-for-profit or non-government organizations (NGOs) entering into formal ‘partnerships’, with stipulated public interest goals and agreed-upon procedures.

Questions may arise about corporate philanthropy, particularly the propriety of corporate donations. Sir Gerard Brennan, former Chief Justice of the High Court of Australia, identified a tension between corporate donations or other forms of charity and the directors’ duty to apply a company’s resources for the benefit of shareholders:

There are sound reasons of policy for imposing a limitation on directors’ powers to donate corporate assets. Investors, whose charitable inclinations are diverse, do not authorise directors to dispose of corporate assets to charitable objects of the directors’ choice. The choice should remain with the individual investor when he or she obtains his or her share of the distributed profits. From

the moral viewpoint, there is no virtue in a directors' resolution to dispose of corporate assets to a charitable object. Virtue consists of the giving of what is one's own, not in the giving of assets that belong to another.³⁵

Similarly, Warren Buffet, chairperson of Berkshire Hathaway, said:

Just as I wouldn't want you to implement your personal judgments by writing checks on my bank account for charities of your choice, I feel it inappropriate to write checks on your corporate 'bank account' for the charities of my choice.³⁶

The Royal Commission report *The Failure of HIH Insurance* (April 2003) touched on issues relating to corporate donations. The Royal Commissioner, Justice Neville Owen, concluded that HIH's procedures with respect to donations constituted a significant departure from appropriate corporate governance practice. He observed that:

The board and management of a company have a good deal of discretion as to how they use the company's funds so long as they act reasonably in the interests of the company. Beyond normal business expenditure, companies not uncommonly make donations to charitable or philanthropic causes or other discretionary contributions including to political parties.

While there is nothing inherently wrong with any of this, it is an area where a board's stewardship responsibilities call for deliberation on how a payment will serve the company's interests and appropriate accountability to shareholders on whose behalf that discretion has been exercised.³⁷

Justice Owen also said that:

however laudable the object of a donation, discretionary payments of this kind from the funds of shareholders

³⁵ Hon. Sir Gerard Brennan, 'Law values and charity' (2002) 76 *Australian Law Journal* 492 at 497.

³⁶ W Buffet, *Berkshire Hathaway Inc, Shareholder—Designated Contributions* 1981.

³⁷ vol 1 p 119.

should be undertaken in a transparent and justifiable way with full regard to the interests of shareholders.³⁸

On this approach, boards have a discretion to donate corporate assets, provided this can be justified in terms of the company's business interests. Particular donations may be seen as benefiting the company by promoting its public image, improving staff morale or motivation or enhancing support in relevant communities. However, anonymous corporate donations, or those which secure recognition only for directors or executives personally, may be more questionable.

An overseas model

The American Law Institute (ALI) *Principles of Corporate Governance* model clause 2.01(b)(3) would give directors a fairly broad discretion in relation to corporate philanthropy. It states that:

Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.³⁹

The ALI Commentary observes that while corporate philanthropy is often seen as enhancing the corporation's long-term economic interests, clause 2.01(b)(3) would in some circumstances permit directors to devote corporate resources to these ends, even without establishing some direct corporate profit or shareholder gain, if that behaviour is reasonable in the circumstances:

Donations should be reasonable in amount in the light of the corporation's financial condition, bear some reasonable relation to the corporation's interest, and not be so 'remote and fanciful' as to excite the opposition of shareholders whose property is being used. Direct corporate benefit is no longer necessary, but corporate interest remains as a motive.⁴⁰

Along the lines of the ALI model clause, statutes in several US states permit corporations to make donations regardless of corporate

³⁸ vol 1 p 120.

³⁹ American Law Institute, *Principles of Corporate Governance: Analysis and recommendations* vol 1 (American Law Institute Publishers, 1994) at 55.

⁴⁰ id at 72, quoting R Garrett, 'Corporate donations' (1967) 22 *Business Law* 297.

benefit. For instance, the New York Business Corporation Law s 202(a)(12) contains a default 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.

1.3.3 Commercial approach

This approach to corporate responsibility emphasises that it is likely to be in a company's own interests, long-term or short-term, to take into account the environmental and social context in which it operates. This perspective challenges the view that directors' duties can only be fulfilled by pursuing maximum profits and returns to shareholders regardless of the societal consequences.

The commercial approach has two aspects:

- corporate benefit
- risk management.

Corporate benefit

Under this aspect of the commercial approach to social responsibility, companies may benefit by:

- adopting business policies and practices designed to build broad community support (sometimes referred to as 'getting a licence to operate'), with a view to enhancing corporate reputation, goodwill, brand image or other intangible assets and protecting or promoting corporate opportunities
- creating a corporate image of social concern and responsiveness that attracts and retains motivated employees, which may lead to improved workplace morale, higher productivity, reduced staff turnover and greater identification of employees with the company
- identifying new business opportunities or markets, or improving market position, by taking into account the needs, expectations or aspirations of stakeholders

- developing a reputation-based competitive advantage over companies that fail to articulate, or are perceived to lag in relation to, socially responsible goals.

This approach is not new. For instance, a survey conducted in the early 1990s reported that a sample of directors of Australia's top 500 companies considered 'that the quest for the good corporate citizen label should not be incompatible with the achievements of the commercial or business objectives of the company'.⁴¹ An example from that period was the decision by certain companies to stop using environmentally damaging propellants in aerosol containers, given the perceived threat to profitability from community reaction to those propellants.⁴²

There is a longstanding and continuing debate about whether adopting particular policies that are perceived as environmentally and socially responsible is likely to improve a company's financial performance or can be justified solely on a return-on-investment basis.⁴³ One difficulty is that it is often easier, or less costly, to quantify the direct financial costs to companies of implementing these policies than to measure their intangible benefits (such as

⁴¹ Tomasic and Bottomley, 'Corporate governance and the impact of legal obligations on decision-making in corporate Australia' (1991) 1 *Australian Journal of Corporate Law* 55 at 56 ff.

⁴² B McCabe, 'Are corporations socially responsible? Is corporate social responsibility desirable?' (1992) 4 *Bond Law Review* 1.

⁴³ Summaries of relevant research are set out in Ernst & Young, *Risk Management Series* (5th edn, July 2005) at 1, and also in the Australian Council of Super Investors Discussion Paper, *Corporate social responsibility: guidance for investors* (September 2005) Section 6 (pp 20–23).

Sustainability Reporting Practices, Performance and Potential (July 2005), a research project by the University of Sydney, examining triple bottom line initiatives and their impact on organizations, suggests (at 91) that a relationship between sustainability initiatives and positive financial performance is becoming evident:

Firms that adopt more extensive sustainability disclosure practices appear to be positively associated with several aspects of financial performance and, in turn, with lower probabilities of financial distress.

Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment* (October 2005) notes (at 95) that:

while there are differing views as to precisely how the links between ESG [environmental, social, governance] factors and financial performance should be identified and measured, the links are widely acknowledged to exist.

employee morale, community support and trust, and overall corporate reputation).

The Australian Stock Exchange (ASX) Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* Principle 10 is consistent with the corporate benefit approach. That principle states that:

Companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital.

It recommends that listed companies ‘establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders’. They should publish (ideally in a clearly marked corporate governance section on their website) a description of any applicable code of conduct or a summary of its main provisions. They should also include within their annual report an explanation of any departure from best practice Recommendation 10.1.

These Corporate Governance Council guidelines are not obligatory for listed companies, though companies that choose not to follow one or more of them must identify in their annual report the guidelines not followed and give reasons for departing from them (the ‘if not, why not’ reporting requirement).⁴⁴

Risk management

This aspect of the commercial approach to social responsibility is based on the view that a well-managed company will have regard to a variety of risk factors that impinge on its operations, extending beyond financial risks to relevant social and environmental risks.⁴⁵

⁴⁴ ASX Listing Rule 4.10.3 requires listed entities to provide a statement in their annual report disclosing the extent to which they have followed the guidelines in the reporting period, identifying any guidelines they have not followed, and giving reasons for not following them (known as the ‘if not, why not’ reporting requirement). See further ss 793C and 1101B regarding the enforcement of ASX Listing Rules.

⁴⁵ Risk profiles may differ considerably between corporations in different commercial sectors, for instance, the risks associated with mineral extraction companies may materially differ from those for service companies.

The early identification and proper management of these non-financial risks may be integral to a company's operational efficiency, its overall financial performance and its long-term shareholder value.⁴⁶ As pointed out by the Australian Council of Super Investors:

From the investor's perspective, identifying social or environmental risks at the point where they impact corporate profit and loss or share returns is simply too

Multinational corporations are also likely to have a different risk profile than national ones. B Kytle and J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) state (at 2) that:

For many companies, going global has meant adopting network-based operating models across different countries, regulatory regimes and cultures ... However, network-based operating models have also resulted in much more complex relationships, both within corporate domains and between corporations and their external operating environments ... gone are the days when companies could easily identify the starting and end points of their value chains and hope to manage them as a closed system.

The authors give the following example of value chain risk (at 7):

Ironically, a social risk may arise from what appears to be a sound business decision. For example, the quest for cheaper labor to drive down costs appears to make good business sense on the basis of competitive advantage ... However, the decision to employ workers in a developing country without full acknowledgement or adherence to international labor standards could cause a company to run afoul of labor rights watchdogs, resulting in unwanted public criticism of its value chain practices.

⁴⁶ The report by SustainAbility and others, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability* (2005), analyses international trends that have increased the risk of litigation against corporations in environmental areas (including climate change) and social areas (including human rights, particularly in developing countries). The report points out that:

litigation can be damaging to a company's reputation even when it is unsuccessful in the courts

and that:

litigation could become an important factor driving share prices in numerous business sectors.

The report points to various factors that have increased the risk of litigation for corporations, including:

the shift by NGOs away from attacking to exploiting legislation and the emergence, particularly in North America, of a highly profitable class actions industry.

The report concludes that:

liability avoidance by good governance, prudent risk management and progressive policies and strategies should be the preferred route to protecting and enhancing shareholder value and maintaining a licence to operate.

late to be able to influence companies through engagement methods such as are pursued by active investors. By the time a social or environmental issue becomes visible within a company's financial drivers, companies generally have few choices about how to manage the issues and are at the mercy of government and public opinion.⁴⁷

The management of non-financial risks may not necessarily maximise 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.⁴⁸ Any adverse outcome may impair a company's business performance and financial position and thereby 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.⁴⁹ Changes in corporate risk profile could also affect directors and officers (D&O) insurance policies.⁵⁰

⁴⁷ ACSI Discussion Paper, *Corporate social responsibility: guidance for investors* (September 2005) at 15.

⁴⁸ The report by SustainAbility and others, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability* (2005) points out that corporate reputation may be damaged well before, or even in the absence of, adverse litigation.

B Kytte and J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) point out (at 6) that:

The number of shareholder resolutions demanding climate change risk management policies from US companies tripled between 2001 and 2002, and climate change-related lawsuits against companies have recently been filed for the first time.

⁴⁹ ss 203C, 203D. All references to statutory sections in this paper are to the *Corporations Act 2001* (the Corporations Act), except where otherwise indicated.

⁵⁰ B Kytte and J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) point out (at 6) that:

Some insurance companies [in the USA] are beginning to demand information from companies for which they provide directors' and officers' liability coverage on whether they have a carbon accounting or reporting system.

This form of non-financial risk has been recognised both nationally⁵¹ and internationally,⁵² 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.⁵³ Also, the nature of

W Baue, *Insurers at the Crossroads: Intersection Between Insurance and Sustainability is a Busy Corner* (2005) commented that some insurance companies are starting to integrate environmental, social and governance performance assessments into decision-making with respect to insurance products, including property, casualty, and directors and officers insurance. Insurance premiums may be adjusted up or down, depending on the extent to which an insurer assesses that a company's environmental and social, as well as governance, risk factors are being well managed.

⁵¹ See, for instance, Ernst & Young, *The Materiality of Environmental Risk to Australia's Finance Sector* (2003).

⁵² For instance, the *United Nations Environment Programme (UNEP) Statement by Financial Institutions on the Environment & Sustainable Development*, signed by leading financial institutions worldwide, states that:

identifying and quantifying environmental risks should be part of the normal process of risk assessment and management, both in domestic and international operations' (para 2.3).

Likewise, the *UNEP Statement of Environmental Commitment by the Insurance Industry*, signed by leading worldwide insurers, states that the insurance company signatories:

will reinforce the attention given to environmental risks in our core activities. These activities include risk management, loss prevention, product design, claims handling and asset management (para 2.1).

In the UK, the Association of British Insurers has issued *Disclosure guidelines on socially-responsible investment*, which includes information that institutional investors would like to see in the annual report of each listed company, including how the company identified and assessed the significant risks to its short- and long-term value arising from social, environmental and ethical matters and the company's systems for managing these risks.

⁵³ Ernst & Young, *The Materiality of Environmental Risk to Australia's Finance Sector* (2003), *The Operating and Financial Review Working Group on Materiality* (UK, 2003).

Notwithstanding the nature of the challenge, there appears to be increasing pressure to quantify the full range of intangible factors. In relation to the assessment of environmental, social and governance factors in investment decision-making, Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment* (October 2005) noted (at 11) that:

... it is increasingly difficult for investment decision-makers to claim that [environmental, social, governance] considerations are too difficult to quantify when they readily quantify business goodwill and other equivalently nebulous intangibles:

Essentially the problem of intangibles can be reduced to the difference between quantitative and qualitative data. Accounting standards are not set in stone, and have evolved and changed over time. It is imperative that accounting standards and systems are altered to account for such intangibles.

non-financial risks and their impact on operations may change over time.⁵⁴

There is no general requirement in Australian law for companies to have risk management systems.⁵⁵ However, the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* Principle 7 is consistent with the risk management approach to corporate social responsibility. It refers to listed companies establishing ‘a sound system of risk oversight and management and internal control’ designed to:

- identify, assess, monitor and manage risk
- inform investors of material changes to the company’s risk profile.

According to the guidance on Principle 7, a company’s risk profile should describe the material risks facing it. In that context, ‘material

⁵⁴ The report by the World Business Council for Sustainable Development *Running the Risk* (2004) suggests (at 6–7) that the potential financial and non-financial risks now facing companies can include 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.

⁵⁵ There are specific risk management requirements for a limited class of entities. For instance, all financial services licensees must have an adequate risk management system (s 912A(1)(h)). See further ASIC Policy Statement 166 *Licensing: Financial requirements*. Bodies regulated by the Australian Prudential Regulatory Authority (APRA) are exempt from this provision, as they are subject to APRA risk management requirements. Likewise, APRA-regulated entities must develop, implement and maintain a sound and prudent risk management framework dealing with financial and non-financial material risks. See, for instance, APRA Guidance Note GGN 220.2 (July 2002), which deals with risk management requirements for insurers, and APRA Superannuation Guidance Note SGN 120.1 (July 2004), which deals with risk management requirements for regulated superannuation funds and approved deposit funds. It is a matter for each regulated entity to devise a risk management system appropriate for its circumstances. For instance, APRA Superannuation Guidance Note SGN 120.1 para 17 makes clear that APRA does not intend to issue templates for entities to follow when devising their risk management frameworks.

risks include financial and non-financial matters'.⁵⁶ The company should make publicly available (for instance, through its website) a description of the company's risk management policy and internal compliance and control system and also include in the corporate governance section of the annual report an explanation of any departures from the best practice approach in Principle 7.

Principle 7, like Principle 10, is not obligatory for listed companies, but instead adopts the 'if not, why not' reporting requirement.

1.3.4 Ethics-based approach

This approach to social responsibility refers to directors taking various ethical values or standards (going beyond the spirit, as well as the letter, of the law) into account in their corporate decision-making, even if this may not enhance corporate profit or shareholder gain. An example might be an in-principle decision of directors that the company will not engage in certain commercial activities, regardless of the opportunities or potential profits, or will not deal with any organization that fails to meet certain environmental or social standards.

This concept is reflected in the American Law Institute (ALI) *Principles of Corporate Governance* model clause 2.01(b)(2):

Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business.

According to the ALI Commentary on this model provision, these ethical considerations:

necessarily include ethical responsibilities that may be owed to persons other than shareholders with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities

⁵⁶ Principle 7 refers to AS/NZS 4360-2004 *Risk Management within the Internal Audit Process* as a possible useful precedent in devising a risk management system. That standard notes that risk management is an integral part of good corporate governance and provides a generic framework for managing risk and adopting consistent risk management practices. See also Group of 100, *Guide to Compliance with ASX Principle 7 'Recognise and Manage Risk'*.

within which the corporation operates. The content of these responsibilities may vary according to the type of business in question and the history and established standards of the particular corporation.⁵⁷

The ALI Commentary further observes that apparent tensions between financial and ethical considerations are often resolved on the basis that compliance with ethical principles may result in long-run financial benefits. Where, however, there may be a conflict between ethical considerations and corporate profitability, the ALI Commentary takes the view that the more appropriate and desirable course would be compliance with ethical considerations, even when doing so would not enhance corporate profit or shareholder gain.⁵⁸

1.3.5 Altruistic approach

This approach to social responsibility is based on the view that, as business has access to valuable resources and the privilege of limited liability, it is part of its role to assist in solving social problems and advancing public welfare, even in the absence of a discernible benefit to the company in so doing.⁵⁹

It has been argued in support of this approach, sometimes described as ‘profit-sacrificing social responsibility’, that:

A duty to act in the interests of the enterprise couldbe understood as a duty to protect the business for the benefit of those groups, in addition to the shareholders, whose interests are likely to be affected by its success

thereby supporting:

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

⁵⁷ id at 63.

⁵⁸ *ibid.*

⁵⁹ This idea is not new. For instance, S Holmes in ‘Executive perceptions of corporate social responsibility’ (1976) 19 *Business Horizons* at 34 referred to a study of executive attitudes to social responsibility, which included considerable support for the proposition that ‘in addition to making a profit, business should help to solve social problems whether or not business helps to create those problems even if there is probably no short-run or long-run profit potential’.

generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation.⁶⁰

1.4 Key concepts

Some key concepts that are commonly referred to in discussion of the above-mentioned approaches are:

- stakeholders
- sustainability
- triple bottom line reporting.

1.4.1 Stakeholders

The notion of ‘stakeholders’ reflects the idea that the conduct of companies can affect a broader range of persons than merely shareholders.

The term has no precise or commonly agreed meaning. Possible definitions range from ‘groups vital to the success and survival of a corporation’⁶¹ to ‘any individual or group who can directly or indirectly affect, or be affected by, that entity’⁶² to ‘any person,

⁶⁰ J Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press, Oxford, 1994) at 79 and 261.

⁶¹ A converse way of saying the same thing is ‘those groups without whose support the organization would cease to exist’: R Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984) at 31.

⁶² According to R Freeman, op cit footnote 61 at 46, a stakeholder is ‘any group or individual who can affect or is affected by the achievement of the organization’s objectives’. See also UN *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003) at para 22. The World Business Council for Sustainable Development defines stakeholders as including shareholders, employees, business partners, suppliers, pressure groups, local communities and the environment: *Corporate Social Responsibility: The WBCSD’s Journey* (2002) at 2.

group or organization that can place a claim on a company's attention, resources or output'.⁶³

The term can include:

- shareholders, who, unlike other stakeholders, have a direct equity interest in the company
- other persons with a financial interest in the company (financiers, suppliers and other creditors), or those in some other commercial legal relationship with the company (for instance, business partners)
- persons who are involved in some manner in the company's wealth creation (employees and consumers)
- anyone otherwise directly affected by a company's conduct (for instance, communities adjacent to a company's operations)
- pressure groups or NGOs, usually characterised as public interest bodies that espouse social goals relevant to the activities of companies.⁶⁴

The term is sometimes also used more generally to include regulators, the financial markets, the media, governments and the community generally.

There are various ways to describe the role of stakeholders in corporate decision-making.

Commercial approach

The view adopted under this approach is that it is in a company's own interests, and consistent with longer term shareholder value, to take into account the legitimate needs and expectations of a range of stakeholders, not just focus on immediate returns to shareholders.

⁶³ B Kytte and J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) at 3.

⁶⁴ See further B Horrigan, 'Fault lines in the Intersection between Corporate Governance and Social Responsibility' (2002) 25 *University of New South Wales Law Journal* 515 at 520, Dr G Zappalà, 'Corporate Citizenship and the Role of the Government: the Public Policy Case', Working Paper no.4 2003-04, Politics and Public Administration Group, 2003 at 5.

The approach challenges any assumption that the wealth of shareholders can only be maximised by sacrificing the interests of other stakeholders.

Companies must comply with all relevant laws that affect or protect the interests of stakeholders: see section 2.5, below. Beyond that, and subject to directors acting in the interests of the company (see sections 2.2 and 2.3, below) and stakeholders enforcing contractual or other legal rights,⁶⁵ it is a matter for the commercial judgment of directors to determine what stakeholder interests to consider in particular situations and how to manage, balance or prioritise them.

For instance, the American Law Institute in its *Principles of Corporate Governance* has observed that:

The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates. The long-term profitability of the corporation generally depends on meeting the fair expectations of such groups. Short-term profits may properly be subordinated to recognition that responsible maintenance of these interdependencies is likely to contribute to long-term corporate profit and shareholder gain. The corporation's business may be conducted accordingly.⁶⁶

Likewise, the OECD *Principles of Corporate Governance* (2004) state that:

The governance framework should recognise that the interests of the corporation are served by recognising the interests of stakeholders [including employees and creditors] and their contribution to the long-term success of the corporation. In all OECD countries, the rights of stakeholders are established by law (e.g. labour, business, commercial and insolvency laws) or by contractual relations. Even in areas where stakeholder interests are not legislated, many firms make additional commitments

⁶⁵ For instance, a creditor may under the terms of a particular contractual covenant be entitled to exercise an increased influence over corporate decision-making in particular situations.

⁶⁶ American Law Institute, *Principles of Corporate Governance: Analysis and recommendations* vol 1 (American Law Institute Publishers, 1994) at 57.

to stakeholders, and concern over corporate reputation and corporate performance often requires the recognition of broader interests.⁶⁷

Stakeholders under this commercial model are not treated as an homogenous group, but may have different interests, needs and expectations. Also, their relationship with the company differs, as noted in the report of the UK Hampel Committee on *Corporate Governance* (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.⁶⁸

Shareholders generally can exert influence through the internal corporate governance structure, as further discussed in section 2.1, below.

Institutional investors and other stakeholders can employ other means of influence, the significance and weight of which are matters for companies to determine in their particular situations. For instance:

- financiers, as well as institutional and other investors, may seek to have companies more closely examine and disclose how they are identifying and dealing with their environmental, social and other non-financial risks and opportunities and the effects on corporate financial viability. The way companies deal with these

⁶⁷ at 46.

⁶⁸ at 1.17.

longer term risk management matters may have significant implications for their ability to attract equity or loan capital⁶⁹

- investors may take into account in their investment decisions whether companies meet certain environmental, social and ethical standards. This approach, usually referred to as ‘socially

⁶⁹ This approach challenges the notion that the only perspective of market analysts and investors is a company’s short-term financial performance and profits against market benchmarks. While immediate financial returns are important to investors and have a direct impact on market share price, some financiers and institutional investors may also be concerned about a company’s longer term viability.

For instance, *Corporate Sustainability—An Investor Perspective* (2003) (the Mays report) examined corporate sustainability (incorporating environmental, social and economic factors) from an investor perspective, including the significance of this framework for financial markets and its possible impact on debt and equity financing. The report pointed to the importance of considering corporate sustainability from the perspective of both risk management and creating corporate opportunity. The report provided various models and case studies on how corporate sustainability could be integrated into corporate management and investor decision-making.

Also, the Australian Council of Super Investors Inc (ACSI), representing various large public and educational sector superannuation funds, has focused on corporate non-financial as well as financial risks. See, for instance, the ACSI Discussion Paper, *Corporate social responsibility: guidance for investors* (September 2005).

A related issue is the extent to which managers of superannuation and other managed investment funds must, or may, take environmental and social factors into account in their investment decision-making. Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment* (October 2005) analysed whether the laws in various European countries, Japan, the United States, the United Kingdom and Australia required or permitted managers to include environmental, social and governance (ESG) factors in their investment decision-making, or prevented them from so doing. The report concluded that:

In our view, decision-makers are required to have regard (at some level) to ESG considerations in every decision they make. This is because there is a body of credible evidence demonstrating that such considerations often have a role to play in the proper analysis of investment *value*. As such they cannot be ignored, because doing so may result in investments being given an inappropriate value (at 10–11).

The report also noted that:

integrating ESG considerations into investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions (at 13).

The report observed (at 44) that Australian investment fund managers had been slower to integrate ESG factors into their investment decisions than managers in other jurisdictions, identifying amongst other reasons, ‘definitional issues and confusion over what constitutes ESG’ and ‘confusion over whether ESG is consistent with fund managers’ fiduciary responsibilities’.

responsible investment' (SRI),⁷⁰ has been assisted by the development of various corporate responsibility market indices.⁷¹ Also, some investment intermediaries are encouraged to assess the conduct of companies by reference to various labour, environmental, social and ethical criteria⁷²

⁷⁰ A useful summary of the history of the SRI movement is found in the ACSI Discussion Paper, *Corporate social responsibility: guidance for investors* (September 2005) at 24.

The report by the University of Technology Sydney, Institute for Sustainable Futures, *Mainstreaming SRI: A role for Government?* (November 2005) contains a summary of legislation and initiatives from various jurisdictions that have promoted SRI. That report also indicated that the policy options that received the most support from finance industry professionals and stakeholders surveyed were:

- requiring financial planners to ask potential customers if they are interested in SRI investing
- mandatory sustainability reporting for the top 200 ASX companies
- applying SRI to the Australian Government Future Fund, and
- requiring all superannuation funds to offer an SRI option.

Various associations have been formed in different countries, including Australia, to promote SRI, including through certification programs designed to help investors make informed choices regarding investment opportunities that take into account environmental, social and ethical considerations as well as financial returns.

The report by AMP Capital Investors *Financial payback from environmental & social factors* (April 2005) summarises some research on whether SRI investing leads to superior portfolio performance.

⁷¹ These indices include the Dow Jones Sustainability Index, the FTSE4Good in the UK, the SRI index in South Africa and the Jantzi Social Index in Canada. A number of indices have developed in Australia, including the SAM Sustainability Index and the Reputex SRI Index.

⁷² The Corporations Act s 1013D(1)(i), introduced in 2002, requires product issuers, if offering a financial product with an investment component (as explained in s 1013D(2A)), to disclose in their product disclosure statements the extent to which they take into account labour standards, or environmental, social or ethical considerations in their selection, retention or realisation of the investment. Product issuers must state that they do not take these standards and considerations into account, if that is the case (Corporations Regulations reg 7.9.14C).

Pursuant to s 1013DA, ASIC has published guidelines for compliance with this requirement: *ASIC guidelines to product issuers for disclosure about labour standards or environmental, social and ethical considerations in Product Disclosure Statements (PDS)* (December 2003). Similarly, in Policy Statement 175 *Licensing: Financial product advisers—Conduct and disclosure*, ASIC takes the view that advisers providing personal advice to their retail clients should enquire whether environmental, social or ethical considerations are important to their clients and, if so, conduct reasonable inquiries about those matters (PS175.110).

- individuals may make decisions whether to work for companies, based on the perceived level of corporate commitment to various environmental or social values. Corporate reputation may be important in attracting, retaining and motivating talented employees ('employers of choice' notion)
- NGOs, local communities or other interest groups may put political or community pressure on companies to adopt certain standards or change certain practices through, for instance, public agitation, 'name and shame' campaigns, calls for product boycotts or legal redress.⁷³ Equally, companies may enhance their reputation by entering into various community-based initiatives or partnerships
- customers may make consumer choices about corporate products based on various factors, including production practices and their environmental and social impact, as well as product safety and reliability considerations.⁷⁴ This process has been assisted by the development of 'social labels' issued by various organizations to indicate those companies that have complied with various labour and other human rights standards, particularly for products produced in low-GDP countries.

The Australian provision is modelled on a UK provision, introduced in 1999, applicable to occupational pension funds. The effect has been that UK pension funds have increasingly incorporated assessments of these non-financial factors in their investment decision-making.

France, Germany, Sweden and Belgium also require managers of pension funds to disclose how they take into account social, environmental and ethical factors in their investment decisions.

⁷³ B Kytte and J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) propose a conceptual framework for managing the various forms of 'social risk' that corporations may encounter as they go global. The authors comment (at 6) that:

From a company's perspective, social risk occurs when an empowered stakeholder takes up a social issue area and applies pressure on a corporation (exploiting a vulnerability in the earnings drivers—eg, reputation, corporate image), so that the company will change policies or approaches in the marketplace.

⁷⁴ Kytte and Ruggie, op cit footnote 73, outlined the history of Nike as an example of a company that suffered commercial detriment in consequence of consumer reaction to the company's production processes, particularly in low-GDP countries.

Companies may also actively promote stakeholder involvement and information feedback through formal ‘engagement’ mechanisms.⁷⁵

Some credit rating agencies are factoring in a company’s performance on stakeholder-related matters in assessing a company’s creditworthiness.⁷⁶

Rights approach

From time to time, suggestions have been made that go beyond the commercial approach to the treatment of stakeholders by proposing that companies should be run for the benefit of, and be accountable to, all stakeholders⁷⁷ and that:

⁷⁵ Kytte and Ruggie, op cit footnote 73, observe (at 10–11) that:

The term ‘engagement’ captures the various mechanisms that have been used by organizations to listen to, and account for, the views of stakeholders, as well as involving them in the provision of solutions. One step above the dissemination of information to stakeholders, a company may begin to engage them before a decision has been made through, for example, joint workshops or task forces. At the next level, stakeholders gain some influence on decision makers in addressing a particular social issue. At the highest level, stakeholders are viewed as co-decision makers in forming an approach or solution. These strategies are examples of completing the feedback loop—both informing stakeholders and having them inform a company around a particular social issue ... Among the key questions that can be answered by engaging with stakeholders on a particular social issue are these: what is the issue or problem?; how complex is it?; what is its scope?; who else has an interest in the problem?; what is working and not working in the current approach?; what would be accomplished by engaging others in the dialogue?

The UK-based organization AccountAbility, the United Nations Environment Programme and Stakeholder Research Associates have published *From Words to Action: the Stakeholder Engagement Manual, vol 2: The Practitioner’s Handbook on Stakeholder Engagement*.

AccountAbility also published in September 2005 an exposure draft *Stakeholder Engagement Standard*. The finally agreed standard is planned for release in late 2006.

⁷⁶ For instance, the Standard & Poor’s Corporate Governance Analytical Framework states that a strong corporate analytical profile includes ‘the maintenance of good public reporting on key issues of employee, community, and environmental activities that address concerns of non-financial stakeholders and maintains an active policy of engagement with diverse investor and stakeholder interests’.

⁷⁷ This concept is referred to in E Sternberg, *Corporate Governance: Accountability in the Marketplace* (Institute of Economic Affairs, London, 2004) Chapter 6 at 127-128.

- directors be obliged (rather than having the option to choose for commercial reasons) to take into account the interests of all relevant stakeholders⁷⁸ and/or
- stakeholders generally, not just shareholders, be given some right to participate in corporate decision-making (going beyond 'engagement' mechanisms).⁷⁹

Any approach of this nature to directors' duties leaves open many questions, such as how directors are to reconcile competing stakeholder interests and how the duties of directors to various stakeholders are to be enforced.

Questions concerning the participation of stakeholders other than shareholders in corporate decision-making include who would appoint these representatives, if not the shareholders, whether shareholders could be obliged to appoint someone to represent sectional non-shareholder interests, and how would the representatives balance those sectional interests with their obligation to act in the best interests of the company.

1.4.2 Sustainability

The concept of sustainability or sustainable development was linked initially to the environmental impact of corporate behaviour, including the effects on natural resources, eco-systems and climate. According to the most widely used description, known as the Brundtland definition:

⁷⁸ For instance, M Blair & L Stout in 'A Team Production Theory of Corporate Law' (1999) 85 *Vanderbilt Law Review* 247 and in 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 *Washington University Law Quarterly* 403 argue that the shareholder primacy principle is an error of legal analysis. The role of the board of directors, as a 'mediating hierarch' is to balance or resolve the competing demands of a corporation's 'team members' for the good of the corporation and the proper sharing of its wealth. That 'team' can include all those stakeholder groups that contribute in some manner to a corporation's wealth production.

⁷⁹ For instance, G Acquah-Gaisie, in 'Toward more effective corporate governance mechanisms' (2005) 18 *Australian Journal of Corporate Law* 1, has raised the suggestion that companies have, in addition to the board of directors, a supervisory board comprising representatives of the corporation's various stakeholder groups (at 43 ff). A precedent is Germany, with its two-tier corporate governance structure that includes employee representatives.

Sustainable development is a form of development that meets the needs of the present without compromising the ability of future generations to meet their own needs.⁸⁰

Much of the discussion on sustainability has been in the international context, with the focus on the role of governments and social groups, as well as corporations, in dealing with the impact of development on the global environment.⁸¹

The Brundtland definition has also been employed by individual companies in recognising that their own viability as a long-term business depends on responsible management of the environmental and social impact of their conduct.⁸² From this has developed the concept of 'sustainable corporate governance' defined as 'a model of corporate governance designed systematically to optimise the company's efforts to achieve social, ecological and economic sustainability objectives'.⁸³

⁸⁰ In 1987, the United Nations established the World Commission on Environment and Development (the Brundtland Commission) to review the world's environment. The report, *Our Common Future* (Oxford University Press, 1987), raised concerns about the harmful impacts that some economic development can have on the world's environment and social structure.

⁸¹ The issue of sustainable development can be traced back as far as the 1972 International Conference on the Human Environment. The UN Conference on Environment and Development in 1992 adopted the Rio Declaration on Environment and Development, the Statement of Principles for the Sustainable Management of Forests (the Rio Principles) and proposals to implement a plan of action globally to deal with the human impacts on the environment (Agenda 21). The Commission on Sustainable Development was created in December 1992 to help implement the Rio Principles and Agenda 21. The World Summit on Sustainable Development in Johannesburg in 2002 reinforced commitment to the Rio Principles and the implementation of Agenda 21.

⁸² The Australian Institute of Company Directors *A guide to sustainability in your company* indicates that sustainability involves managing a company for its long-term as well as immediate financial future and for this purpose recognising the importance of a company's social and environmental responsibilities. The Business Council of Australia has also promoted this concept: see *Towards Sustainable Development—How leading Australian and global corporations are contributing to sustainable development* (May 2001).

⁸³ Future E.V. and Institute for Ecological Economy Research GmbH, 2004.

1.4.3 Triple bottom line/sustainability reporting

The concept

The origins of triple bottom line (TBL) or sustainability reporting (sometimes also referred to as corporate social responsibility reporting) can be traced back at least to the 1980s, when various US companies, in response to growing community concerns, began publishing reports on the environmental impact of their activities. TBL reporting evolved during the 1990s to complement conventional financial reporting and focuses on the environmental, social and economic impact of corporate activities.⁸⁴

The standards and guidelines that have been developed for TBL reporting tend to focus on descriptive, rather than merely quantitative, reporting. Also, there is an overlap between financial and non-financial reporting. For instance, certain information regarding environmental impact, such as a company's environmental liabilities and contingencies, may also be relevant to financial statements.

The mixture of environmental, social and economic factors may differ between companies. For instance, the environmental impact of a mining company would be more significant than that of a financial services business.

The benefits of TBL reporting

Some proponents of TBL reporting argue that, as well as informing the market, it can assist the internal processes of corporate management. According to one commentary:

⁸⁴ The concept of triple bottom line reporting was developed by J Elkington in *Cannibals With Forks: The Triple Bottom Line of 21st Century Business* (Capstone Publishing Limited, Oxford, 1997). The principles are summarised in Chapter 4. According to the author (at 76):

A key concept in relation to all three dimensions of sustainability—but particularly relevant in relation to environmental and societal costs—is that of 'externalities'. These economic, social or environmental costs are not recorded in accounts. So, to take an economic example, the decision of a company to locate a high-technology plant in a relatively undeveloped region may have such effects as drawing technical talent away from local firms, or forcing up property prices locally beyond what local people can afford.

In addition to the benefits obtained through superior relationships with key stakeholder groups, the decision to be publicly accountable for environmental and social performance is often recognised as a powerful driver of internal behavioural change. The availability of relevant information on economic, environmental and social performance that previously may not have been collected and evaluated in a readily understood manner may enable executives to identify and focus attention on specific aspects of corporate performance where improvement is required.⁸⁵

GRI Guidelines

The Global Reporting Initiative (GRI) *Sustainability Reporting Guidelines 2002* are increasingly being recognised as the global benchmark for voluntary sustainability or triple bottom line reporting,⁸⁶ though they are not the only internationally recognised reporting initiative.⁸⁷

The GRI guidelines require companies choosing to adopt them to:

- provide a description of their governance and management systems to show how sustainability is managed within an organization
- assess and report on the environmental, social and economic effects of their activities, products and services by reference to various indicators and guidelines.⁸⁸

⁸⁵ Group of 100, *Sustainability: A Guide to Triple Bottom Line Reporting* (2003) at 16.

⁸⁶ KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* (June 2005) stated that 40% of sustainability reports worldwide mentioned the use of GRI guidelines.

⁸⁷ For instance, the New York based Social Accountability International arranges for third party auditors to certify whether a company conforms with the SA8000 standards, which focus mainly on labour practices.

⁸⁸ According to the *Global Reporting Initiative (GRI) 2002 Sustainability Reporting Guidelines*:

The board or CEO must state that the report represents a balanced view of their organization's environmental, social and economic performance.

The GRI guidelines have been designed to allow for their incremental adoption by companies. If reporting organizations state that they have prepared a public report in accordance with the GRI, they are required to identify which guidelines they have employed and what criteria in the guidelines they do and do not address. This information is also designed to improve the comparability, verifiability and consistency of reports.

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- *environmental impact* means an organization's impact on living and non-living natural systems, including eco-systems, land, air and water. Examples include energy use and greenhouse gas emissions. There are 16 core environmental indicators, including the environmental impacts of products and services; energy, material and water use; greenhouse gas and other emissions; effluence and waste generation; impacts on biodiversity; use of hazardous materials; recycling, pollution, waste reduction and other environmental programs; environmental expenditures; and fines and penalties for non-compliance
 - *social impact* means an organization's impact on the social system within which it operates. This includes labour practices, human rights and other social issues. There are 24 core social indicators, grouped into three clusters: labour practices (eg, diversity, employee health and safety), human rights (eg, child labour, compliance issues), and broader social issues affecting consumers, communities and other stakeholders (eg, bribery and corruption, community relations)
 - *economic impact* means an organization's impact both direct and indirect on the economic resources of its stakeholders and on economic systems at the local, national and global levels. There are 10 core economic indicators, including the reporting organization's wages, pensions and other benefits paid to employees; monies received from customers and paid to suppliers; and taxes paid and subsidies received.

The GRI has sector supplements that help interpret the guidelines within particular industry sectors, such as automotive, financial services, mining and metals, public sector agencies, tour operators and telecommunications.

Other international organizations have published material to complement and assist in implementing the GRI guidelines.⁸⁹

An increasing number of multinational companies, as well as some larger companies and public sector entities in Australia, have chosen to adopt the GRI or other sustainability guidelines in their reporting, though the level of reporting by Australian listed companies appears to be less than the average for OECD countries.⁹⁰ Some of these

⁸⁹ For instance, the United Nations has published a *Manual for the Preparers and Users of Eco-efficiency Indicators* (2004) to guide enterprises on how to define, recognise, measure and disclose environmental and financial information through co-efficiency indicators, so that enterprises may report on these indicators in a standardised format that is comparable between enterprises. These indicators are designed to complement and support existing reporting guidelines such as the GRI.

⁹⁰ KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* (June 2005), offers a comprehensive analysis of reporting trends worldwide. The review examined corporate responsibility reporting trends of the world's largest corporations, including the top 250 companies of the Fortune 500 (Global 250) and the top 100 companies in 16 countries (National 100). The review concluded that there has been a steady rise in corporate responsibility reporting over the last decade, with a substantial increase in the last three years. It indicated that 52% of Global 250 companies and 33% of National 100 companies now provide some form of corporate responsibility report. The uptake of public reporting in Australia is increasing, though it is still comparatively low. It has grown from 14 of the top ASX 100 companies in 2002 to 23 of the top ASX 100 companies in 2005. The highest reporting ratios are from Japan (80%) and the UK (71%). Australia is number 11 out of the 16 countries surveyed.

Such survey results on international trends still have to be considered in the broader context that well over 50,000 multinational companies still fail to report on corporate social responsibility issues: Ernst & Young, *Risk Management Series* (5th edn, July 2005) at 3.

The *State of Sustainability Reporting in Australia 2005* (by KPMG Australia, CAER and Deni Green Consulting Services) indicates that there has been a significant increase in the rate of sustainability reporting in Australia over recent years, from 1% of the top 500 companies in Australia in 1995, to 13% of such companies in 2000 and 24% of such companies in 2005. However, the rate of sustainability reporting by the top 100 listed companies in Australia in 2005 is significantly less than the average of 41% for 16 OECD countries. These details are set out in the *KPMG Submission to the PJC Inquiry on Corporate Social Responsibility* (September 2005) (Submission 53).

entities have also chosen to have their GRI reports verified, audited or assured by independent experts who attest that the information in the reports is accurate.⁹¹

Some Australian public sector bodies have been involved in developing methodologies to assist entities that choose to adopt the GRI principles⁹² as well as preparing their own reports applying those principles.⁹³

The CPA Australia research document *Sustainability Reporting Practices, Performance and Potential* (July 2005) surveyed a range of Australian private sector bodies, as well as Commonwealth, State and Territory public sector bodies, that had prepared TBL reports. It noted a low level of reporting among government business enterprises. It also stated that, more generally, there were wide variances in the format and scope of private and public sector reports that were produced. The report suggested that, among other factors, the low level and variable nature of reporting that it identified may be attributable to a reluctance or inability of organizations to modify or develop tools, processes and frameworks for sustainability reporting.

⁹¹ In addition to internationally recognised verification frameworks (namely the *AA1000 Series Assurance Standard*, SA8000 and International Auditing and Accounting Standards Board *International Standard on Assurance Engagements* (ISAE 3000)), see, in the Australian context, Standards Australia Standard DRO 3422 *General Guidelines on the Verification, Validation and Assurance of Environmental and Sustainability Reports* (March 2005). In addition, Australian Auditing and Assurance standards (AUS 102) can be used in the audit of sustainability reports.

KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* (June 2005), noted a strong rise in the number of reports with some form of external assurance. However, the report also noted some inconsistencies in approach.

⁹² Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (June 2003).

⁹³ Department of the Environment and Heritage, *Triple Bottom Line Report 2003–04: Our environmental, social and economic performance* (September 2004); Department of Family and Community Services, *Our commitment to social, environmental and economic performance: triple bottom line report 2003–04* (October 2004).

This is in addition to any obligations public sector bodies have under specific legislation. For instance, the *Environment Protection and Biodiversity Conservation Act 1999* s 516A requires Commonwealth entities to include in their annual reports information on their environmental performance and their contribution to ecologically sustainable development.

Future trends and issues

The GRI *Sustainability Reporting Guidelines* are still evolving.⁹⁴ A third version of those guidelines is foreshadowed for publication in 2006.⁹⁵

The number of corporations, nationally and globally, that choose to adopt the GRI or other voluntary TBL reporting guidelines will be influenced by various factors. On the one hand, companies can use TBL reports to demonstrate to capital markets and the general public that they are aware of, and responding to, the societal context in which they operate, including how they are managing the associated risks, opportunities and impacts (sometimes referred to as the ‘what gets measured gets managed’ principle). These reports can also enhance their reputation, assist in attracting capital or staff and advance their competitive position.⁹⁶

Problems that TBL reports may raise for stakeholders, as well as companies, include possible information overload, the sometimes

⁹⁴ The GRI is continuing to develop its technical protocols to assist users in measuring specific indicators (for instance, energy use) that form part of the Guidelines. Each protocol provides detailed definitions, procedures, formulae and references to ensure consistency between reports. Over time, most GRI indicators will be supported by a specific technical protocol. Also, GRI is developing further sector supplements to cover sustainability issues that arise in the apparel and footwear, energy utilities and logistics and transportation industries.

⁹⁵ There is ongoing debate about the content of the foreshadowed 2006 GRI guidelines. For instance, the Certified General Accountants Association of Canada paper, *Measuring Up: A Study on Corporate Sustainability Reporting in Canada* (2005) at 84–85 suggests that there are too many core indicators and that some of them are too qualitative and difficult to report.

⁹⁶ The *State of Sustainability Reporting in Australia 2005* (by KPMG Australia, CAER and Deni Green Consulting Services), which asked respondents about the merits of sustainability reporting, indicated that the key perceived benefits include reputation enhancement, ability to benchmark performance, operational and management improvements, gaining the confidence of investors, insurers and financial institutions and recruiting and retaining high quality staff. These details are set out in the *KPMG Submission to the PJC Inquiry on Corporate Social Responsibility* (September 2005) (Submission 53). There is currently a debate about how well sustainability and other forms of corporate social responsibility reports are meeting the expectation of financial markets. For instance, a report by the German-based organization Pleon, *Accounting for Good: The Global Stakeholder Report 2005*, based on a global survey of shareholders, investors and analysts, reported that many respondents considered that many current sustainability and other non-financial reports did not adequately explain the economic benefits to a corporation stemming from its commitment to sustainability or other social responsibility goals.

vague or imprecise nature of the non-financial reporting criteria and methods of measuring these intangibles, and the lack of fully standardised reporting criteria, all of which may increase the difficulty of comparing the performance of companies across borders or industries.⁹⁷ These problems may be accentuated for multinational corporations, which may also face an array of disclosure and reporting standards across various jurisdictions and sectors.

Companies, including smaller enterprises, may be concerned about the start-up and ongoing costs of TBL reporting,⁹⁸ whether there are discernible benefits for these outlays⁹⁹ and whether TBL reports could attract liability.¹⁰⁰ They also need to consider whether to have

⁹⁷ The CPA Australia research document *Sustainability Reporting: Practices, Performance and Potential* (July 2005) commented that:

The diversity of reporting scope and format impedes comparison of environmental and social performance between entities ... there is a need to develop more accessible approaches and guidelines to enable entities to discharge a broader accountability than is currently reflected in reporting practices in the public and private sectors in Australia (at 19).

The report by B Foran, M Lenzen & C Dey, *Balancing Act: A triple bottom line analysis of the 135 sectors of the Australian economy* (2005), seeks to quantify triple bottom line accounting to underpin broader societal calls for industry, government and institutions to make decisions on a broader basis than just the financial bottom line.

One of the goals of the forthcoming 2006 GRI guidelines is to improve the ability of stakeholders to compare the performance of companies within industry sectors.

⁹⁸ The *State of Sustainability Reporting in Australia 2005* (by KPMG Australia, CAER and Deni Green Consulting Services) indicated that the principal perceived impediments to undertaking sustainability reporting were cost, including developing an initial framework for measuring and reporting and undertaking external verification, and the availability of indicators. These details are set out in the *KPMG Submission to the PJC Inquiry on Corporate Social Responsibility* (September 2005) (Submission 53).

⁹⁹ An example of this concern is found in the report by the University of Technology Sydney, Institute for Sustainable Futures, *Mainstreaming SRI: A role for Government?* (November 2005), which concluded that the largest barrier to sustainability reporting identified by respondents to a survey it had conducted was the lack of identifiable benefits for the outlays.

¹⁰⁰ For instance, any information that a company provides, even on a voluntary basis, could found an action at common law or under the *Trade Practices Act* for alleged misrepresentation. An overseas precedent is *Kaski v Nike* (California Supreme Court), which involved allegations that some voluntary statements made by Nike on its socially responsible business practices were untrue and misleading. In consequence of this litigation, and other negative publicity, Nike undertook fundamental changes to its work relations practices: S Zadek, 'The Path to Corporate Responsibility' *Harvard Business Review* (1 December 2004).

their reports independently verified or audited, to improve their credibility and overcome possible perceptions of ‘greenwashing’ through selective positive reporting.¹⁰¹

The Government has asked the ASX Corporate Governance Council to consider introducing sustainability reporting for listed companies into its *Principles of Good Corporate Governance and Best Practice Recommendations*, on the same voluntary ‘if not, why not’ reporting basis as the existing principles.¹⁰²

1.5 Request for submissions

The Advisory Committee invites you to forward submissions on any aspect of the matters raised in this chapter.

In so doing, you may wish to respond to one or more of the following questions:

- 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

¹⁰¹ The GRI Guidelines recommend corporations indicate their policy and practice in relation to having their reports independently verified. Some respondents referred to in the report by Pleon, *Accounting for Good: The Global Stakeholder Report 2005*, questioned the credibility of some corporate social responsibility reports that had not been independently verified. The CPA Australia research document *Sustainability reporting: Practices, Performance and Potential* (July 2005) was critical of the content of some sustainability reports by Australian corporations, stating that:

Considerable diversity exists in the scope and form of sustainability reporting practices, within the small proportion of companies providing discrete reports. The nature of the information reported was overwhelmingly positive, with negative information being couched in positive terms. Reporting frameworks and standards were not typically employed and verification of the stand-alone reporting was sporadic (at 1).

¹⁰² This request has come from the Minister for the Environment and Heritage, Senator the Hon. Ian Campbell, as referred to in the *Department of the Environment and Heritage Submission to the PJC Inquiry on Corporate Social Responsibility* (Submission 116).

- do 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 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
- 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 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)
 - are there particular issues for small to medium enterprises?

2 Directors' duties: current position

This chapter outlines:

- *the powers and duties of directors that are relevant in considering their ability to conduct the affairs of companies in a socially responsible manner; the analysis suggests that, while required to act in the interests of shareholders generally, directors are not precluded from having regard to effects on other groups or social or environmental considerations that may bear on those ongoing interests*
- *the legal regime under which directors can be held to account for the exercise of their powers and duties*
- *the framework of laws of general application within which corporate activities must be conducted.*

2.1 Division of power within a corporation

Under the traditional corporate governance model, the power to manage a company's affairs derives from the shareholders who together hold the equity interest in the company. In strictly formal terms, the power to manage is delegated by the shareholders to the directors. However, this delegation is subject to certain matters that are reserved for decision by shareholders as a whole under the Corporations Act and the ASX Listing Rules¹⁰³ or the particular terms of corporate constitutions.

The role of the board is to direct, or supervise the management of, the affairs of the company on an ongoing basis. These powers are

¹⁰³ Some of the matters reserved for decision by shareholders under the Corporations Act and the ASX Listing Rules are summarised in the Advisory Committee report, *Shareholder Participation in the Modern Listed Public Company* (June 2000) para 1.5, footnote 5 (available at www.camac.gov.au).

granted in the corporate constitution and by legislation.¹⁰⁴ In exercising these powers, the board is not subject to shareholder direction.¹⁰⁵ In large companies in particular, it is common for directors to delegate day-to-day decision-making to senior managers, who are responsible under their direction and supervision.

The principal method for shareholders to make corporate decisions on matters reserved to them is through resolutions at company general meetings. Shareholders can use this mechanism to seek to have the company adopt various environmental or social policies or goals.¹⁰⁶ For instance, they may propose resolutions to include a

¹⁰⁴ At common law, the division of powers between the board and the company in general meeting is determined by its constitution: *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34. See now s 198A (a replaceable rule), which provides that the business of a company is to be managed by or under the direction of the directors, except for any powers reserved to the shareholders under the Corporations Act or the corporate constitution. A replaceable rule applies only to a company incorporated since July 1998 or any company registered before that time that subsequently repeals its constitution (s 135(1)(a)). A company that is subject to a replaceable rule can displace or modify that rule by its constitution (s 135(2)).

¹⁰⁵ *NRMA v Parker* (1986) 4 ACLC 609. However, the chair of an annual general meeting must allow a reasonable opportunity for the members as a whole at the meeting to ask questions about or make comments on the management of the company (s 250S).

The rationale for this managerial autonomy is reflected in the *OECD Principles of Corporate Governance* (2004), which observe that:

As a practical matter ... the corporation cannot be managed by shareholder referendum ... Moreover, the corporation's management must be able to take business decisions rapidly. In light of these realities and the complexity of managing the corporation's affairs in fast moving and ever changing markets, shareholders are not expected to assume responsibility for managing corporate activities ...

¹⁰⁶ Shareholders of public companies who satisfy the numerical threshold requirements in s 249N may propose a resolution for consideration at the next general meeting of the company. Shareholders who satisfy the numerical threshold requirements in s 249D may call a general meeting of the company. Shareholders need to frame their resolutions appropriately, as a general meeting does not have the power to pass binding resolutions that interfere with the exercise of powers vested in the board: *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89 at 105; *Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 at 134; *Scott v Scott* [1943] 1 All ER 528; *NRMA v Parker* (1986) 4 ACLC 609. For instance, a proposed resolution by shareholders that the company adopt particular environmental or social policies or goals could be part of a proposed amendment to the company's constitution (s 136(2)) (which requires a special resolution) or a proposal to appoint or remove one or more directors (ss 201E, 201G, 203D) (which requires an ordinary resolution). The chairman at a general meeting may choose to permit resolutions to be put to the meeting, even though they are not necessarily linked to either of those matters.

'social responsibility' charter in the company's constitution requiring the board to take into account various environmental or social factors, or the interests of various stakeholders, not just shareholders.¹⁰⁷ Directors have a duty to act in accordance with a company's constitution.

2.2 Common law fiduciary duties

At common law, directors are obliged to act in the interests of 'the company as a whole'. This phrase has been interpreted to mean the financial well-being of the shareholders as a general body.¹⁰⁸ Directors are also obliged to consider the financial interests of creditors when the company is insolvent or near-insolvent, though they have no direct fiduciary duty to creditors.¹⁰⁹ These common law principles continue to apply to directors, in addition to statutory requirements discussed at 2.3, below.¹¹⁰

Directors are not confined in law to short-term considerations in their decision-making, such as maximising immediate profit or share price return. The interests of a company can include its continued long-term well-being.¹¹¹ It is a matter for the commercial judgment

Non-binding resolutions are confined to executive remuneration (s 250R).

¹⁰⁷ In *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 291, the High Court stated that:

the articles of a company may be so framed that they expressly or impliedly authorise the exercise of [a] power ... for what would otherwise be a vitiating purpose.

¹⁰⁸ An alteration to a constitution requires a special resolution (s 136(2)). *Greenhalgh v Arderne Cinemas* [1950] 2 All ER 1120; *Ngurli Ltd v McCann* (1953) 90 CLR 425. Directors owe their duties to shareholders collectively, not individually, except in very limited circumstances, where a duty can arise in relation to particular dealings: *Percival v Wright* [1902] 2 Ch 421; *Pine Vale Investments Ltd v McDonnell & East Ltd* (1983) 8 ACLR 199; *Brunninghausen v Glavanics* (1999) 32 ACSR 294; *Southern Cross Mine Management Pty Ltd v Ensham Resources Pty Ltd* (2004) 22 ACLC 724.

¹⁰⁹ Directors of a company approaching insolvency are obliged to consider the interests of creditors as part of the discharge of their duties to the company: *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722. However, directors have no direct fiduciary duties to creditors: *Spies v R* (2000) 201 CLR 603. In consequence, the duty the directors owe to the company is not enforceable by creditors.

¹¹⁰ s 185.

¹¹¹ In *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSWLR 424 at 440, Helsham J stated that directors should consider the interests of future as well as existing shareholders.

of directors how to balance or prioritise shorter and longer term considerations. These principles apply equally to the statutory fiduciary duties, discussed at 2.3, below.

The meaning of acting in the interests of the company as a whole has developed through the case law. The overriding test is the well-being of the company and therefore the shareholders generally. Thus, for instance, directors have been permitted to grant bonuses to current employees on the reasoning that this may indirectly benefit the company in terms of increased morale and loyalty.¹¹² By contrast, ex gratia distributions of funds to past employees or their family members have generally been held not to be in the interests of the company, as such voluntary distributions were not reasonably incidental to the ongoing business of the company or otherwise beneficial to it.¹¹³

In *Darvall v North Sydney Brick & Tile Co Ltd* (1987) 12 ACLR 537 (affirmed (1989) 15 ACLR 230), the Court upheld the decision by directors to frustrate a takeover bid for the company by entering into a joint venture transaction, which in the view of directors would provide greater benefits to shareholders in the longer term. Hodgson J said that:

... it is proper to have regard to the interests of present and future members of a company, on the footing that it would be continued as a going concern (at 554).

Compare also *Paramount Communications, Inc v Time Inc* 571 A.2d 1140 (Del. 1989), where the Delaware Supreme Court ruled that directors were entitled to make decisions based on their perception of the long-term interests of the corporation, even if this sacrificed short-term maximisation of shareholder value. This case was analysed in L Johnson & D Millon, 'The Case Beyond Time' (1990) 45 *Business Law* 2105.

¹¹² *Hampson v Price's Patent Candle Co* (1876) 45 LT Eq 437.

¹¹³ In *Hutton v West Cork Railway Co* (1883) 23 ChD 654, the Court considered the circumstances in which directors could spend corporate funds for the benefit of employees or others, over and above any legal obligations to them. The Court said:

They [the directors] can only spend money which is not theirs but the company's, if they are spending it for the purposes which are reasonably incidental to the carrying on of the business of the company ... 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 ... charity has no business to sit at a board of directors qua charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it [the company], and to that extent and in that garb ... charity may sit at the board, but for no other purpose.

The case law does not rule out all ex gratia payments. In the leading case of *Parke v Daily News* [1962] 1 Ch 927, the court required that, to be valid, such voluntary payments must:

- be reasonably incidental to the carrying on of the company's business
- be a bona fide transaction, and
- be done for the benefit and to promote the prosperity of the company.¹¹⁴

Subsequent case law outside the area of ex gratia payments has emphasised that company directors have a considerable discretion over the factors they may choose to take into account in determining what will benefit the company.

For instance, in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance Oil NL)* (1967) 121 CLR 483 at 493, the High Court observed that:

Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.¹¹⁵

Likewise, in *re Lee, Behrens & Co Ltd* [1932] 2 Ch 46 at 51, the court ruled invalid an annuity granted to the widow of a former managing director on the ground that it was not 'done for the benefit and to promote the prosperity of the company'.

These principles were applied in *Parke v Daily News* [1962] 1 Ch 927, where the Court invalidated a proposal to make ex gratia payments to former employees of a company that was in the process of selling off most of its business. The Court held that these voluntary payments would not directly or indirectly benefit the ongoing economic interests of the company or its shareholders.

¹¹⁴ A useful recent analysis of each of these tests is found in E Klein & J Du Plessis, 'Corporate donations, the best interest of the company and the proper purpose doctrine' (2005) 28 *University of New South Wales Law Journal* 69 at 88 ff.

¹¹⁵ The reason for this judicial reluctance to interfere with the decisions of directors was summed up by Kirby P in *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 15 ACLR 230 at 247:

In *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288, a Canadian Court said:

The classical theory is that a director's duty is to the company. The company's shareholders are the company and therefore no interests outside of those of the shareholders can be considered by the directors ... [But] A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting bona fide in the interests of the company itself. 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.

I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of the company's shareholders in order to confer a benefit on its employees: *Parke v Daily News* [1962] 1 Ch 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

More recently, in *People's Department Stores Inc v Wise* (2004) 244 DLR (4th) 564, the Supreme Court of Canada, in upholding *Teck Corporation*, stated that:

in determining whether [directors] 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.¹¹⁶

courts properly refrain from assuming the management of corporations and substituting their decisions and assessments for those of directors. They do so, inter alia, because directors can be expected to have much greater knowledge and more time and expertise at their disposal to evaluate the best interests of the corporation than judges.

¹¹⁶ para 42.

However, directors are still required to exercise their discretion to benefit the company. For instance, in *Woolworths Ltd v Kelly* (1990) 4 ACSR 431 at 446, Mahoney J said:

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 or do more than it need do only if, essentially, it be for the benefit or for the purposes of the company that it do such.

The legal position was usefully summarised in the report of the 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) as follows:

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.¹¹⁷

In relation to corporate donations and other forms of philanthropic or altruistic activity, directors have a considerable discretion in relation to the use of corporate funds and other assets, provided there is some reasonable connection between those activities and the furtherance of the company's commercial interests:

It is clearly open to companies to engage in activities which, viewed in isolation, may suggest pure altruism—provided that there is some connection (which is rational and, while it may be speculative, is nevertheless cogent) between those activities and the furtherance of the company's commercial interests represented by the financial well-being of its shareholders.¹¹⁸

¹¹⁷ At 6.3, referring to JD Heydon, 'Directors' Duties and the Company's Interests' in P Finn (ed), *Equity and Commercial Relationships* (Law Book Company, 1987) at 135.

¹¹⁸ Unpublished paper by RI Barrett (1999).

Other commentators take a similar view and also identify various factors that impose a reasonableness test on what philanthropic activities directors may undertake on behalf of their companies.¹¹⁹

2.3 Statutory fiduciary duties

Directors are subject to a range of statutory fiduciary duties in conducting the affairs of a corporation. Of these, the two most

¹¹⁹ Q Digby & L Watterson in 'Pursuing profit, productivity and philanthropy: the legal obligations facing corporate Australia' *Keeping Good Companies* (June 2004) comment that:

Shareholders seem to be increasingly aware that corporate social responsibility, including the donation of corporate funds to charity, is good for business. Restricting unselfish activity on the part of companies could operate to the detriment of a company, in terms of damage to goodwill, reputation and the loss of other indirect benefits.

The authors refer to various legal constraints in Australian corporate law that impose a form of reasonableness test on what philanthropic activities directors may undertake on behalf of their companies, including:

- any restrictions on corporate philanthropy in the company's constitution
- the duties of care and diligence, which may be breached if corporate philanthropy undermines the company's financial position
- the requirement that corporate donations be made in good faith and for a proper purpose
- the prohibition on directors improperly using their corporate position or information
- the need to take the position of creditors into account if a company is at risk of insolvency
- the prohibition on insolvent trading.

E Klein & J Du Plessis, 'Corporate donations, the best interest of the company and the proper purpose doctrine' (2005) 28 *University of New South Wales Law Journal* 69 observe (at 96) that benefits to the corporation through corporate donations can include enhanced reputation over the long term:

This will be sufficient except where no reasonable director could have believed that the company's reputation would be enhanced, or where the cost [of the donations] is out of all proportion to the benefit, such that no reasonable director could have thought it to be in the interests of the company to make the payment.

The authors conclude (at 97) that:

From a practical point of view, directors who are sympathetic to the concept of corporate philanthropy can be encouraged that there is plenty of scope for making donations to worthy causes. There are however two important provisos. First, corporate donations must be made as part of a business strategy, the primary motivation being to advance the interests of the corporation. This may be unfashionable but it is a legal requirement. Secondly, donations must be made in a transparent, accountable way. This is not required by law but it is an expectation which directors ignore at their own peril.

relevant to the issues relating to corporate social responsibility are ss 180 and 181.

2.3.1 Section 180

The duty

Subsection 180(1) of the Corporations Act requires directors and other corporate officers to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise in the same position.

The courts have held that s 180(1) adopts an objective standard of care and diligence.¹²⁰ Failure to exercise reasonable care and diligence is not established unless it was reasonably foreseeable at the time the directors acted (not with the benefit of hindsight) that their conduct might harm the interests of the company.¹²¹ In applying that test, the foreseeable risk of harm must be balanced against the potential benefits which could reasonably accrue to the company from the conduct.¹²² However, it would be a breach of the duty of care and diligence for directors to allow a company to enter into a transaction or arrangement that had no prospect of producing a benefit to it.¹²³

Business judgment rule defence

Directors and other officers who make business judgments are taken to have satisfied the duty of care and diligence in s 180(1) if they can show that they rationally believed the judgment was in the best interests of the corporation (s 180(2)). Under this provision, '[that] belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.'

¹²⁰ *ASIC v Vines* [2005] NSWSC 738 at [1058]–[1060].

¹²¹ In *ASIC v Vines* [2005] NSWSC 738 at [1077], Austin J stated, in relation to the forerunner of s 180, that:

The statutory standard [of care and diligence], like the general law, permits the court to take into account the circumstances of the particular case, and requires the standard to be applied to those circumstances as they existed at the relevant time, without the benefit of hindsight.

¹²² *Vrisakis v ASC* (1993) 11 ACSR 162 at 211–213; *ASIC v Doyle* (2001) 38 ACSR 606 at 641, para [222].

¹²³ *Gamble v Hoffman* (1997) 24 ACSR 369, *ASIC v Adler* (2002) 41 ACSR 72.

2.3.2 Section 181

The duties

Section 181 of the Corporations Act obliges directors and other corporate officers to exercise their powers and discharge their duties 'in good faith and in the best interests of the corporation' and also 'for a proper purpose'.

Best interests of the corporation

As well as acting in good faith, directors must satisfy the objective test of acting 'in the best interests of the corporation'.¹²⁴ In applying that objective test, the courts consider that it is the role of the directors to determine what is in the best interests of the company, unless no reasonable director could have reached the decision.¹²⁵

According to a leading text:

- directors are required to act in the interests of the company, but their decisions do not have to satisfy the additional standard of being the best possible decisions for the company¹²⁶
- although there may be no direct legal obligation in company law on directors to take the interests of stakeholders other than shareholders into account, this does not preclude directors from choosing to do so:

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

¹²⁴ See further the analysis in the Advisory Committee report *Sections 181 and 189 of the Corporations Law* (October 2000) (available at www.camac.gov.au), which noted that, before the enactment of the current s 181, it was proposed that a subjective test apply, namely that directors act 'in what they believe to be in the best interests of the corporation'. However, the final legislation omitted the subjective phrase 'in what they believe to be'.

¹²⁵ *Darvall v North Sydney Brick & Tile Co Ltd* (1987) 12 ACLR 537 at 553; *Re HIH Insurance Ltd*; *ASIC v Adler* (2002) 41 ACSR 72 at [738]–[740].

¹²⁶ RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.2.

is no prospect of commercial advantage to the company.¹²⁷

Proper purpose

Directors may only exercise their powers 'for a proper purpose'. The courts have held that this is an objective test, and mere honest belief of propriety by the directors does not suffice to establish that they have acted for a proper purpose.¹²⁸

The case law on 'proper purpose' has focused particularly on internal corporate control issues, such as directors issuing shares to preserve or alter shareholder control or exercising powers to influence the outcome of takeover bids.¹²⁹

The courts have not closely considered what, if any, limits the 'proper purpose' requirement imposes on directors in taking into account the broader environmental and social context in their decision-making. A possible example of an improper purpose would be a corporate donation provided to gain recognition for the directors personally rather than the corporation.

2.4 Enforcement of statutory fiduciary duties

2.4.1 Civil penalty and criminal liability

Possible civil penalties for breach of the statutory fiduciary duties, including ss 180 and 181, include a pecuniary penalty order of up to

¹²⁷ id at 7.13.

¹²⁸ *ASIC v Adler* (2002) 41 ACSR 72 at [738]-[740]. The rationale for this objective test was put forward by Bowen LJ in *Hutton v West Cork Railway Co* (1883) 23 ChD 654 at 671:

Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying its money with both hands in a manner perfectly bona fide yet perfectly irrational.

¹²⁹ RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.19–7.22. Another useful recent summary of the types of actions that have tended to be challenged on the ground of alleged improper purpose is found in E Klein & J Du Plessis, 'Corporate donations, the best interest of the company and the proper purpose doctrine' (2005) 28 *University of New South Wales Law Journal* 69 at 76.

\$200,000,¹³⁰ compensation orders¹³¹ and disqualification from managing a corporation.¹³² The criminal penalties for breach of s 181, where the fault elements in s 184(1) are established, can include up to 5 years imprisonment. A convicted person is also automatically disqualified from managing a corporation for at least 5 years.¹³³

2.4.2 Injunction and/or damages

Where a person 'has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute' a contravention of the Corporations Act, including ss 180 and 181, the court may, on the application of ASIC, or of a person 'whose interests have been, are or would be affected by the conduct', grant a final or interim injunction to stop the conduct¹³⁴ or order the person in breach to pay damages.¹³⁵

The courts have indicated that to have standing to commence an action under s 1324, the applicant must have an interest more than merely as an ordinary member of the public.¹³⁶

¹³⁰ s 1317G.

¹³¹ s 1317H.

¹³² s 206C.

¹³³ s 206B.

¹³⁴ s 1324(1), (4).

¹³⁵ s 1324(10).

¹³⁶ *Broken Hill Proprietary Co Ltd v Bell Resources Ltd* (1984) 8 ACLR 609, *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 23 ACSR 715.

In the subsequent case of *Australian Securities and Investments Commission v Mauer-Swisse Securities Ltd* (2002) 42 ACLR 605, the Court (at 613) suggested that where ASIC, rather than a private litigant, is an applicant, a court is more likely to give greater weight to the broad question whether the injunction would serve a purpose within the contemplation of the Corporations Act. Also, where ASIC is acting to protect the public interest, the absence of any undertaking as to damages on its part will usually be of little consequence (id at 614). By contrast:

where the proceedings are brought to advance a plaintiff's private interests, then if such an undertaking [as to damages] is not proffered even though it is likewise exempted under [s 1324(8)], the court may take that circumstance into account as a matter of practicality, common sense and fairness in determining where the interests of justice lie and whether 'it is desirable' to grant the injunction (ibid).

In *Liwszyc v Smolarek* [2005] WASC 199, the court granted an injunction under s 1324.

2.4.3 Statutory derivative actions

One or more shareholders may seek the leave of the court to bring an action in the name of the company to enforce civil remedies against any director, including for breach of the fiduciary duties under ss 180 and 181.¹³⁷

2.4.4 Oppression

One or more shareholders may take an oppression action against directors if their conduct of the company's affairs is either contrary to the interests of the shareholders as a whole or is oppressive to one or more of them.¹³⁸

2.5 Compliance with public laws

Companies are subject to a range of Federal, State and Territory laws of general application that are designed to protect various interest groups or public values, including environmental protection, occupational health and safety, workplace relations, consumer protection, anti-discrimination and anti-corruption statutes.

Directors cannot ignore or subordinate these corporate obligations because of any notion either that the financial or other interests of shareholders are paramount or that compliance with these laws may reduce shareholder returns.¹³⁹ Rather:

- directors who disregard these laws, or fail to take appropriate steps to ensure that their company complies with them, may breach their common law and statutory fiduciary duties to the

¹³⁷ ss 236, 237.

¹³⁸ ss 232–235. There is extensive case law on the relevant concepts and principles in these provisions: see, for instance, HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (Butterworths loose-leaf) [11.430]–[11.496].

¹³⁹ B Horrigan, 'Fault lines in the Intersection between Corporate Governance and Social Responsibility' (2002) 25 *University of New South Wales Law Journal* 515 at 539 commented that:

compliance with anti-pollution and workplace safety laws to prevent harm to employees and the environment unquestionably increases the cost of business but nobody seriously frames this in terms of an unjustified distraction from the financial bottom line or something which compromises the primary directive to satisfy shareholder interests.

company.¹⁴⁰ They may also be personally liable in consequence of offences committed by their companies under these laws¹⁴¹

- directors who fail to act properly in this respect do not have the excuse that the financial or other interests of shareholders have priority over corporate compliance.¹⁴²

2.6 ASX

The ASX Corporate Governance Council, in its *Principles of Good Corporate Governance and Best Practice Recommendations* Principle 10, proceeds on the basis that company directors, under the current law, have the power to take broader community factors into account in corporate decision-making. The principle states that:

Companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital.

It recommends that listed companies establish and disclose a code of conduct to guide their compliance with legal and other obligations to legitimate stakeholders.

2.7 Request for submissions

The Advisory Committee invites you to forward submissions on any aspect of the matters raised in this chapter.

In so doing, you may wish to respond to one or more of the following questions:

¹⁴⁰ S Bielefeld, S Higginson, J Jackson & A Ricketts in 'Directors' duties to the company and minority shareholder environmental activism' (2004) 23 *Company and Securities Law Journal* 28 analyse relevant principles and case law.

¹⁴¹ See further the Advisory Committee Discussion Paper *Personal liability for corporate fault* (May 2005) (available at www.camac.gov.au).

¹⁴² See further S Bielefeld, S Higginson, J Jackson & A Ricketts, 'Directors' duties to the company and minority shareholder environmental activism' (2004) 23 *Company and Securities Law Journal* 28.

- 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
- 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
- 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?

If you have any proposal for change, how might it be implemented and work in practice and how might directors be held to account?

3 Directors' duties: matters for consideration

The Advisory Committee has been asked to consider two issues relating to directors' duties that arise in discussing the interests that can be taken into account in corporate decision-making, namely, 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 or whether directors should be required to do so. This chapter analyses two possible alternative approaches, if change is considered necessary, namely, a 'pluralist' approach, adopted in various states of the USA, and an 'elaborated shareholder benefit' approach, an example of which is currently under consideration in the United Kingdom.

3.1 Two approaches

As seen from the analysis in Chapter 2, directors have considerable discretion concerning the interests they may take into account in corporate decision-making, provided their purpose is to act in the interests of the company as a whole, interpreted as the financial well-being of the shareholders as a general body. It is a matter for consideration whether any change in the present position is required or would be worthwhile.

The question whether the law should go further by expressly permitting or requiring directors to take into account the interests of stakeholders other than shareholders has been considered from time to time, primarily in the context of two diverging approaches:

- *a pluralist approach*, under which other certain stakeholders would be on a par with shareholders, and
- *an elaborated shareholder benefit approach*, being an explicit statement of interests for directors to take into account in advancing the financial well-being of shareholders generally.

3.2 Pluralist approach

3.2.1 Overview

A pluralist approach to directors' duties would go beyond the current law by permitting or requiring directors to serve a wider range of interests in their corporate decision-making, not subordinate to, or merely a means of achieving, shareholder well-being.

Much of the debate on a pluralist approach has centred on concerns that, depending on how such a provision was expressed, it could either subject directors to conflicting or competing fiduciary duties and obligations of accountability or in effect free them of any such duties or obligations.

Other concerns with a pluralist approach include how to identify relevant classes of stakeholders, what stakeholders should have standing to enforce the duties, whether courts might become involved in making commercial decisions if called on to balance or weigh up competing stakeholder interests, and whether criminal or civil enforcement of directors' duties would be compromised if directors could refer to a range of competing or conflicting stakeholder interests in defending claims of breach of duty.

Another often-expressed view is that environmental or social concerns should be dealt with through specific legislation on those matters, rather than by changing the content of directors' duties under the Corporations Act along pluralist lines.

The report of the 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) (the Senate report) referred to some of these concerns in opposing any statutory mandatory or permissive pluralist provision for directors' duties.

Statutes in various states of the USA expressly permit directors to take into account the interests of various non-shareholder groups or the broader community in their decision-making. These 'corporate constituency' provisions were introduced primarily in the context of corporate takeovers, though many of them are not restricted in their terms to change of control matters.

3.2.2 1989 Senate report

Mandatory provision

This report opposed any move to introduce legislation obliging directors to have regard to the interest of groups other than shareholders in making decisions.

It considered that a mandatory provision could place the directors beyond the effective control of shareholders without significantly enhancing the rights of other parties. The report pointed out that:

It is the shareholders' investment that creates the company. Directors' fiduciary duties are premised on this fact and are designed to protect that investment. If company law were to impose new and, at times, contradictory duties (such as looking after interests which may be directly opposed to those of the [shareholders]) directors' fiduciary duties could be weakened, perhaps to the point where they would be essentially meaningless.¹⁴³

The report considered that:

Duties owed to non-shareholders ... would also create problems ... The people to whom the duties were owed could have diverse and often directly opposed interests. A director cannot meaningfully act 'in the interests' of such a group. All that can be asked is that he or she act 'fairly' as between the various elements.

To impose a duty to act fairly between entities as diverse as creditors, employees, consumers, the environment, is to impose a broad and potentially complex range of obligations on directors. Such a duty could be vague. Directors are already required to act fairly between competing groups of shareholders, but, in that situation, shareholdings provide a set of similar, or at least comparable, rights from which criteria for fairness can be developed. ... This is not the case where the competing interests are of completely different kinds. With no firm standard by which to judge directors' actions the law 'abandons all effective control over the decision-maker'.

Without a legally-ordered set of priorities between the various groups, it would be difficult for any claim by one

¹⁴³ para 6.51.

group to be upheld, as the directors' action could probably be characterised as being in the interest of some other group or groups. The question of who could enforce the various duties in the courts would also be difficult.¹⁴⁴

Permissive provision

The Senate report also opposed any provision expressly permitting directors to have regard to the interest of groups other than shareholders in making corporate decisions.

It considered that directors could become less accountable under a permissive provision:

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. Meanwhile, shareholders' ability to bring directors to account for failing to act in the interests of the company would be weakened by the directors' legal licence to have regard to the interests of outsiders.¹⁴⁵

Specific legislation

The Senate report recommended that, rather than introduce any mandatory or permissive provision, matters such as the interests of consumers or environmental protection be dealt with in legislation aimed specifically at those matters, rather than in corporations legislation.¹⁴⁶

3.2.3 US corporate constituency statutes

US corporations are governed by the laws of the state in which they are incorporated. Statutes in a majority of those states (though not including Delaware, where many large US companies are incorporated) provide for directors to take into account the interests of various non-shareholder groups or broader community considerations in their decision-making. These corporate constituency statutes typically are permissive in allowing, but not requiring, corporate decision makers to consider the broader

¹⁴⁴ paras 6.45–6.47.

¹⁴⁵ para 6.44.

¹⁴⁶ para 6.56.

constituency. They were developed from the 1980s primarily in response to concerns raised by corporate management about hostile takeovers. Approximately half the statutes are confined to takeover or other change of control situations, while the remaining statutes are not so limited.¹⁴⁷

These statutes typically do not give standing to persons other than shareholders to take actions against directors. However, directors might be able to rely on these broader considerations in response to any claim that they had breached their fiduciary duties by placing the interests of other parties above those of shareholders.

An example of an unrestricted permissive corporate constituency statute is the New York Business Corporation Law s 717 (duty of directors), introduced in 1992, which provides that:

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 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.

¹⁴⁷ For a useful summary, see K Hale, 'Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823.

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.

The merits of corporate constituency statutes were closely debated at the time of their introduction.

One view was that these statutes would allow directors to focus more broadly on the overall impact of corporate action, but without diminishing shareholder interests, given the voting power of shareholders.¹⁴⁸

The American Bar Association Committee on Corporate Laws (the ABA Committee) considered that:

The better interpretation of these statutes ... is that they confirm what the common law has been: directors may take into account the interests of other constituencies but only as and to the extent that the directors are acting in the best interests, long as well as short term, of the shareholders of the corporation.¹⁴⁹

Nevertheless, the ABA Committee expressed strong reservations about such legislation:

While legislatures may not have intended it, adding [these] provisions to state corporation laws may have ramifications that go far beyond a simple enumeration of the other interests directors may recognise in discharging their duties ... The confusion of directors in trying to comply with such statutes, if interpreted to require directors to balance the interests of various constituencies without according primacy to shareholder interests, would be profoundly troubling ... Furthermore, an articulation of a director's duties that extended them to other constituencies without primacy being accorded to shareholder interests would diminish the ability of shareholders to monitor appropriately the conduct of directors ... The Committee believes that other constituencies statutes are not an appropriate way to

¹⁴⁸ See, for instance, L Mitchell, 'A theoretical and practical framework for enforcing corporate constituency statutes' (1991) *70 Texas Law Review* 579.

¹⁴⁹ ABA Committee on Corporate Laws, 'Other Constituencies Statutes: Potential for Confusion' (1990) *45 Business Law* 2253 at 2269.

regulate corporate relationships ... Those statutes that merely empower directors to consider the interests of other constituencies are best taken as a legislative affirmation of what courts would be expected to hold, in the absence of a statute.¹⁵⁰

Other critics of these statutes have argued that they would convert directors into 'unelected civil servants' with a responsibility for determining the public interest.¹⁵¹

In practice, the permissive provisions appear to have been utilised primarily, if not exclusively, in the context of takeover defences. Of the few US cases that have referred to constituency statutes in the first decade of their operation, none insisted that directors demonstrate that they in fact have deliberated about, or balanced, stakeholder interests to gain the protection of the statute.¹⁵²

3.3 Elaborated shareholder benefit approach

3.3.1 Overview

This approach would require directors, as under the current law, to act for the benefit of the shareholders of a company as a whole. However, it would go beyond the current statutory provisions by expressly referring to various considerations that directors may take into account in determining what is for the benefit of shareholders generally.

One proposal of this nature, described as a 'duty to promote the success of the company', is now before the UK Parliament. If enacted, it would be part of the first statutory statement of directors' duties in British corporate law. In the Australian context, it could be characterised as a way to elaborate on the requirement in s 181(1)(a)

¹⁵⁰ id at 2269 ff.

¹⁵¹ See further J Macey, 'An economic analysis of the various rationales for making shareholders the exclusive beneficiaries of corporate fiduciary duties' (1991) 21 *Stetson Law Review* 23, S Bainbridge, 'Interpreting Nonshareholder Constituency Statutes' (1992) 19 *Pepperdine Law Review* 971.

¹⁵² M Polonsky & P Ryan, 'The Implications of Stakeholder Statutes for Socially Responsible Managers' (1996) Vol 15 No 3 *Business & Professional Ethics Journal* 3 at 16.

for directors and others to act 'in good faith and in the best interests of a corporation'.

This legislative initiative derives from the work of the UK Company Law Review Steering Group (the Steering Group), begun in its consultation paper *Modern Company Law for a Competitive Environment: The Strategic Framework* (February 1999). The Steering Group described its proposal to elaborate on the matters to take into account in determining the benefit of the shareholders as the 'enlightened shareholder value' approach.

3.3.2 UK Steering Group

The Steering Group considered that directors should:

have regard to the need, where appropriate, to build long-term and trusting relationships with employees, suppliers, customers and others, as appropriate, in order to secure the success of the enterprise over time.¹⁵³

However, the Steering Group observed that directors' duties as currently expressed and interpreted in practice:

often tend to lead to an undue focus on the short-term and the narrow interest of members at the expense of what is in a broader and a longer-term sense the best interest of the enterprise, and thus its value to members as ultimate controllers able to realise that value.¹⁵⁴

The Steering Group compared the differences between the pluralist approach and its 'enlightened shareholder value' approach as follows:

There will inevitably be situations in which the interests of shareholders and other participants will clash, even when the interests of shareholders are viewed as long-term ones. Examples include a decision whether to close a plant, with associated redundancies, or to terminate a long-term supply relationship, when continuation in either case is expected to make a negative contribution to shareholder returns. In such

¹⁵³ *Modern Company Law for a Competitive Environment: The Strategic Framework* (February 1999), para 5.1.22.

¹⁵⁴ para 5.1.17.

circumstances, the law must indicate whether shareholder interests are to be regarded as overriding, or some other balance should be struck. This requires a choice ... between the enlightened shareholder value and pluralist approaches. An appeal to the 'interests of the company' will not resolve the issue, unless it is first decided whether 'the company' is to be equated with its shareholders alone (enlightened shareholder value) or the shareholders plus other participants (pluralism).¹⁵⁵

Pluralist approach

According to the Steering Group, directors' duties under this approach:

would be reformulated to either permit or require directors to further the interests of non-shareholder participants, such as employees, customers and suppliers, even if this were to the detriment of shareholders.¹⁵⁶

This approach 'envisages circumstances in which some sacrifice of the interests of shareholders will be needed in favour of some other interest'.¹⁵⁷

The Steering Group did not attempt to define precisely the wider group of non-shareholder participants, nor the circumstances, if any, in which those participants might have legal remedies against directors for failing to consider their interests.

Another possibility under the pluralist approach referred to by the Steering Group would be to alter board composition to require a wider representation of non-shareholder interests.¹⁵⁸ The Steering Group did not further explore the ramifications of such an approach, including who would appoint these representatives, if not the shareholders, whether shareholders could be obliged to appoint someone to represent interests other than themselves, and how

¹⁵⁵ para 5.1.15.

¹⁵⁶ para 5.1.30.

¹⁵⁷ para 5.1.13.

¹⁵⁸ para 5.1.32.

would the representatives balance their sectional interests with their obligation to act in the best interests of the company.¹⁵⁹

'Enlightened shareholder value' approach

The Steering Group, in favouring what it described as the 'enlightened shareholder value' approach, noted that the focus would still be on achieving shareholder value, but the directors would have greater flexibility to take into account longer term considerations and the interests of various non-shareholder groups in advancing shareholder value:

Companies which are properly managed and controlled by directors and members with long-term vision and insight will in their own enlightened self-interest ensure that they take proper account of these wider objectives. Increasing importance is now rightly attached by companies to their dependence on corporate reputation or commercial success; they are under increasing scrutiny from governments, regulators, the press, pressure groups and non-governmental organisations and the communities in which they operate; employees and investors are increasingly aware of the risks and difficulties of involvement with companies which have an unacceptable reputation.¹⁶⁰

3.3.3 The 2005 UK Bill

Clause 156 of the Company Law Reform Bill 2005 adopts the 'enlightened shareholder value' approach put forward by the Steering Group, but now described as a 'duty to promote the success of the company'. The clause makes clear that directors owe their fiduciary duty only to the shareholders generally, rather than a range of interest groups, but seeks to provide a broader context for fulfilling that duty.

¹⁵⁹ The case law of nominee directors has considered some of these issues of balancing sectional interests and the best interests of the company. See, for instance, the Advisory Committee *Corporate Groups Final Report* (May 2000) at 2.94 ff (available at www.camac.gov.au).

¹⁶⁰ para 5.1.41.

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.

3.3.4 Comments on the UK Bill provision

According to a member of the Steering Group:

- cl 156(1) is intended to articulate the common law view that the company means its shareholders as a whole. The phrase 'in the interests of the company' was intentionally omitted as being meaningless
- cl 156(3)(a) is consistent with the common law, which has never required short-termism
- cl 156(3)(b)-(e) seeks to make clear that although shareholder interests are predominant, the promotion of these interests does not require 'riding roughshod' over the interests of other groups on whose activities the business of the company depends for success:

The interests of non-shareholder groups thus need to be considered by the directors, but, of course, in this shareholder-centred approach, only to the extent that the protection of those other interests promotes the interests of the shareholders.¹⁶¹

Some questions that could be raised about the clause include:

- whether the phrase 'a director ... considers' in cl 156(1) introduces a subjective test and, if so, how that compares with the objective test in s 181(1)(a) of the Corporations Act that directors must act 'in the best interests of the corporation'
- whether the requirement in cl 156(3) that 'a director must (so far as reasonably practicable) have regard to' various matters set out in that clause could create an undue risk, either that directors may breach their duties in seeking to reconcile these matters in particular situations or, conversely, that directors would have an undue discretion about what matters to take into account in particular situations

¹⁶¹ Professor P Davies, 'Enlightened Shareholder Value and the New Responsibilities', WE Hearn Lecture at the University of Melbourne Law School, 4 October 2005.

- whether any consequences follow from the specific reference in cl 156(3)(b) and (c) to some, but not necessarily all, possible stakeholder groups.

3.4 Request for submissions

The Advisory Committee invites you to forward submissions on any aspect of Questions 1 and 2 in the terms of reference, namely:

- 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?

In so doing, you may wish to respond to one or more of the following questions:

- 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 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
 - how might any proposed amendment be implemented and enforced

- 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?

4 Corporate reporting

The Advisory Committee has been asked to consider whether certain types of companies should be required to report on the environmental and social impact of their activities, in narrative or quantified form.

This raises the adequacy of current reporting requirements in meeting the reasonable needs for relevant social and environmental information of shareholders, other stakeholders and the market generally. Current requirements include the recently enacted s 299A, as well as the ASX Listing Rule reporting requirements and the ASX Corporate Governance Council Principles 7 and 10.

By way of background and comparison, relevant developments in a number of other countries are outlined.

4.1 Purpose of reporting

Periodic reporting by companies on the environmental and social impact of their activities may benefit stakeholders and the broader community in various ways, such as:

- assisting shareholders and the market to determine how well companies are dealing with non-financial, as well as financial, risks
- helping investors with particular ethical concerns to make better informed decisions
- informing other stakeholders about the societal impact of a company's conduct.

Enhanced reporting by companies may also engender greater managerial attention to the societal impact of corporate activities as a consequence of collecting relevant information for the purpose of reporting. Reporting may also stimulate higher standards of corporate conduct by facilitating comparisons between entities and

across business/industry sectors on social and environmental indicators.

As noted by one commentator in relation to environmental disclosure:

Disclosure of significant environmental data concerning a company's operations can influence public opinion, investment decisions, regulatory enforcement activity and the company's own priorities in decision-making. In this way, disclosure provisions might potentially play a significant role in curbing environmental degradation.¹⁶²

4.2 Voluntary reporting

Companies may, and quite often do, choose to provide environmental and social non-financial information to the market through various means, including:

- volunteering information on environmental and social matters in their annual reports, over and above statutory requirements¹⁶³
- preparing a triple bottom line or other form of sustainability report to accompany the annual report
- participating in relevant market indices¹⁶⁴

¹⁶² Gunningham & Prest, 'Environmental audit as a regulatory strategy: prospects and reform' (1993) 15 *Sydney Law Review* 493.

¹⁶³ Some analysts have been critical of the level of non-financial reporting in Australia. For instance:

Energy-use and GHG emissions data is under-reported by Australian companies (BT Financial Group Position paper, *Energy-use* at 1).

Likewise:

Currently, fewer than one in four of Australia's listed companies report having a OHS management system that demonstrates a commitment to comprehensive risk identification, assessment and control (BT Financial Group Position paper, *Workplace health and safety governance* at 3).

¹⁶⁴ One example of this form of initiative is the Australian *Corporate Responsibility Index*. This is a voluntary self-assessment managerial tool to enhance the capacity of businesses to develop, measure and communicate socially and environmentally responsible corporate conduct. It has been adopted by some ASX-listed corporations. Results of the latest annual survey of participating companies were reported in the *Sydney Morning Herald* and the *Age* on 4 April 2005.

- using informal methods of disclosing information, such as targeting community opinion leaders or striving to achieve relevant ratings and awards, to convey a company's social responsibility goals and performance.¹⁶⁵

4.3 Continuous disclosure

Each listed disclosing entity is required to disclose to the market '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'.¹⁶⁶ These requirements would cover information relating to environmental and social matters that satisfies this materiality test. Some exceptions apply. Under the Corporations Act, similar obligations apply to unlisted disclosing entities.¹⁶⁷

4.4 Annual reporting

4.4.1 Statutory requirements

All companies (other than some small proprietary companies) and registered managed investment schemes must prepare and file with ASIC an annual report, comprising:

- a financial report, and
- a directors' report.¹⁶⁸

Annual reports must be provided to company shareholders¹⁶⁹ and must also be lodged with ASIC and thereby be accessible to the public.¹⁷⁰

¹⁶⁵ The Australian Council of Super Investors Discussion Paper, *Corporate social responsibility: guidance for investors* (September 2005) discusses (at 5.1.2) some of the informal communication methods available to companies.

¹⁶⁶ ss 674-678; ASX Listing Rule 3.1.

¹⁶⁷ s 675(1)(b). The same materiality test as in ASX Listing Rule 3.1 is set out in s 674(2)(c). The tests for determining listed and unlisted disclosing entities are set out in Part 1.2A Div 2 of the Corporations Act.

¹⁶⁸ ss 292-294.

¹⁶⁹ s 314.

¹⁷⁰ s 319.

Financial report

The Corporations Act prescribes the content of the financial report, including various declarations by directors and others concerning solvency and compliance with accounting standards.¹⁷¹

The financial report can be of value for a range of stakeholders, not just shareholders.¹⁷² Also, some matters that could be included within a non-financial reporting framework can have direct financial implications.¹⁷³ However, there is no requirement that non-financial environmental and social aspects of a company's operations be covered in the financial report.¹⁷⁴

¹⁷¹ ss 295–297.

¹⁷² See, for instance, Australian Accounting Standards Board (AASB), *Framework for the Preparation and Presentation of Financial Statements* (July 2004) para 9, which summarises the use of financial reports for a range of stakeholders including investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public.

¹⁷³ For instance, AASB 137 requires the financial accounts to include information related to any environmental restoration. Also, International Accounting Standard (IAS) 37 (Provisions, Contingent Liabilities and Contingent Assets (1998)), issued by the International Accounting Standards Board, includes accounting requirements for various corporate liabilities. This standard has implications for corporate social responsibility, for instance, in its accounting requirements concerning any 'constructive obligation'. This term covers any obligation that derives from an enterprise's actions where:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities, and
- as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A 'constructive obligation' could arise, for instance, from company publications (such as public reports or policy statements on a company's website) that outlined corporate social responsibility/sustainability undertakings or commitments given by that company. An example might be where a company, in response to public expectations, undertook to rectify environmental damage on land used in its business, over and above any legal obligation to do so.

¹⁷⁴ AASB *Presentation of Financial Statements* (AASB 101) para 10 states that: 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.

Directors' report

The directors' report covers a range of general information concerning the operation of the company, including its principal activities and outcomes during the year, as well as some forward-looking information.¹⁷⁵ This includes:

- s 299(1)(f)
- s 299A

which cover various categories of non-financial information. Section 299A—which is a new provision—is the first generic statutory reporting requirement that goes beyond financial reporting.

s 299(1)(f). This provision, which came into effect in July 1998, provides that:

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—[the annual directors' report must] give details of the entity's performance in relation to environmental regulation.

The provision only applies to an entity that is subject to 'particular and significant' environmental regulation, thereby imposing a materiality threshold test. Also, the provision requires an entity to give details of its 'performance' in relation to environmental regulation.

s 299A. Under this provision, listed companies are now required to include in the directors' report any information that shareholders would reasonably require to make an informed assessment of:

- the operations of the company reported on
- its financial position, and
- the company's business strategies and its prospects for future financial years.

¹⁷⁵ ss 298–300A.

There is an exception for any material the publication of which would result in unreasonable prejudice to the company.¹⁷⁶

This provision was introduced in response to a recommendation in the Royal Commission report *The Failure of HIH Insurance* (April 2003) concerning the need to include an operating and financial review (OFR) in annual reports.¹⁷⁷ The Royal Commissioner referred to the proposals (subsequently introduced) in the United Kingdom for an OFR, containing such information as the directors decide is necessary to obtain an understanding of the business, including details of the company's performance, plans, opportunities, corporate governance and management risks.

The Royal Commissioner was of the opinion that:

such a document, which would be the subject of audit, would significantly assist in addressing the short-comings of audited accounts presented in accordance with the historical cost convention and other standards which can impede the utility of the accounts as a transparent assessment of the financial progress of the company.¹⁷⁸

Section 299A does not specify the same level of detail as required in the UK OFR provisions, which, for instance, specifically refer to risks and information about the impact of the business on the environment, employees or other interests. The Explanatory Memorandum to s 299A stated that the provision was intentionally expressed in broad terms:

- to enable directors to make their own assessment of the information needs of shareholders of the company and tailor their disclosures accordingly; and

¹⁷⁶ s 299A(3).

¹⁷⁷ See Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 para 4.391 and Royal Commission report *The Failure of HIH Insurance* (April 2003), vol 1 at 182 and Recommendation 13.

¹⁷⁸ at 182.

- to provide flexibility in form and content of the disclosures, as the information needs of shareholders, and the wider capital market, evolve over time.¹⁷⁹

The Explanatory Memorandum also commented that, in considering the issues to be addressed in their review, directors are expected to have regard to best practice guidance such as the *Guide to the Review of Operations and Financial Condition* prepared and published by the Group of 100 Inc.¹⁸⁰

The provision applies to annual reports of listed companies from 2005. While potentially a significant development, it will take some time to assess any change in quantity or quality of information reported as a result of the new provision. Being part of the directors' report, the information will be subject to audit.

4.4.2 ASX requirements

Listing Rules

ASX Listing Rule 4.10.17 requires ASX-listed entities to include a review of operations and activities for the reporting period.

The note to that Listing Rule states that, while the ASX does not require the review to follow any particular format, it supports the Group of 100 Inc publication *Guide to the Review of Operations and Financial Condition*.

The Guide (which is reproduced in Guidance Note 10 of the ASX Listing Rules) states that:

To meet information needs of its shareholders, capital market participants and an increasing array of other stakeholders ('users'), a company should explain its past performance and provide information which will increase understanding of its future directions. This can be achieved through a Review which provides a critical and objective analysis and explanation of a company's past and likely future performance and financial condition, concentrating on the opportunities and risks associated

¹⁷⁹ Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 para 5.306.

¹⁸⁰ id at paras 4.388, 5.307.

with the past operations of the company and the opportunities and risks likely to impact on the future activities of the company.

The Review should provide users with an understanding of the company by providing a short-term and long-term analysis of the business as seen through the eyes of the directors. This will be facilitated by providing useful financial and non-financial information and analysis.¹⁸¹

The Guide makes some specific references to social and environmental factors. For instance:

It should outline the opportunities and risks in respect of the industries and locations in which the company operates and the legal, social and political environments which affect the company and its activities.¹⁸²

The Review should include a discussion and analysis of key financial and non-financial performance indicators (KPIs) used by management in their assessment of the company and its performance ... Where practical, KPIs ... should include multiple perspectives such as sustainability measures including social and environmental performance measures, where relevant.¹⁸³

The Review should provide a commentary on the strengths and resources of the company whose value may not be fully reflected in the statement of financial position ... Disclosure of information about unrecognised intangible assets such as ... human resources, customer and supplier relationships and innovations is helpful to users in making decisions.¹⁸⁴

Corporate Governance Council principles

The ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* set out best practice guidelines for all companies listed on the ASX. These

¹⁸¹ Overview.

¹⁸² para 7.

¹⁸³ para 8.

¹⁸⁴ para 27.

guidelines are not obligatory, but apply an ‘if not, why not’ reporting requirement.¹⁸⁵

Principle 7: recognise and manage risk. This Principle refers to listed companies establishing ‘a sound system of risk oversight and management and internal control’ designed to:

- identify, assess, monitor and manage risk
- inform investors of material changes to the company’s risk profile.

According to the guidance on Principle 7:

- a company’s risk profile should describe the material risks facing it. In that context, ‘material risks include financial and non-financial matters’¹⁸⁶
- the company should make publicly available (for instance, through its website) a description of the company’s risk management policy and internal compliance and control system and also include in the corporate governance section of the annual report an explanation of any departures from the best practice approach in Principle 7.

Principle 10: recognise the legitimate interests of stakeholders. This Principle refers to listed companies establishing and disclosing a code of conduct to guide compliance with their legal and other obligations to legitimate stakeholders. The Principle sets out various suggestions for matters to be covered by that code of conduct.

This Principle requires listed companies to publish (ideally in a clearly marked corporate governance section on their website) a

¹⁸⁵ ASX Listing Rule 4.10.3 requires listed entities to provide a statement in their annual report disclosing the extent to which they have followed the guidelines in the reporting period, identifying any guidelines they have not followed, and giving reasons for not following them (known as the ‘if not, why not’ reporting requirement). See further ss 793C and 1101B regarding the enforcement of ASX Listing Rules.

¹⁸⁶ Principle 7 refers to AS/NZS 4360-2004 *Risk Management within the Internal Audit Process* as a possible useful precedent in devising a risk management system. That standard notes that risk management is an integral part of good corporate governance and provides a generic framework for managing risk and adopting consistent risk management practices. See also Group of 100, *Guide to Compliance with ASX Principle 7 ‘Recognise and Manage Risk’*.

description of any applicable code of conduct or a summary of its main provisions. They should also include within their annual report an explanation of any departure from the best practice Recommendation in Principle 10.

Sustainability. The Government has asked the ASX Corporate Governance Council to consider introducing sustainability reporting into its *Principles of Good Corporate Governance and Best Practice Recommendations*, on the same voluntary ‘if not, why not’ reporting basis as the existing principles.¹⁸⁷

4.5 Overseas reporting requirements

Over the last decade, there has been a shift towards greater disclosure by corporations of their environmental and social impact. Recent initiatives, including in the United Kingdom and South Africa, have accentuated this trend.

4.5.1 United States

SEC regulations

The Securities and Exchange Commission (SEC) reporting obligations under Items 101, 103 and 303 of Regulation S-K include environmental disclosure requirements. These requirements apply to all companies subject to SEC rules (registrants).

The obligation to disclose under any of these Items only applies to information that is material. SEC reg 240.12b-2 defines ‘material’ as follows:

the term ‘material’, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.

¹⁸⁷ This request has come from the Minister for the Environment and Heritage, Senator the Hon. Ian Campbell, as referred to in the *Department of the Environment and Heritage Submission to the PJC Inquiry on Corporate Social Responsibility* (Submission 116).

This reasonable investor test has in general been interpreted to limit the disclosure obligation to any information that is likely to have an immediate effect on the share price of a corporation. This short-term focus means that the disclosure provisions, outlined below, do not apply to longer term environmental trends or developments affecting corporations.

Goals of environmental disclosure

The US Environment Protection Authority (EPA) in 2001 summarised the goals of these disclosure requirements, as they apply to environmental factors, as follows:

The Federal securities regulatory system relies on US Securities and Exchange Commission registrants to fully disclose material information to actual and potential shareholders to ensure they can make informed investments, and for proper market functioning. Moreover, full and fair disclosure of material information related to a firm's environmental performance, compliance and liabilities is essential if stock markets are to accurately reflect the financial condition of publicly traded companies.

Item 101

This item requires each registrant to file a general description of its business.

This description must include information about the material impact that environmental regulations will have on the registrant's capital expenditures, corporate earnings, and general competitive position. Under (c) *Narrative description of business*, para (xii):

Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.

Item 103

This item requires each registrant to disclose information relating to legal proceedings.

Paragraph 5 requires disclosure, on at least a quarterly basis, of any actual or pending administrative or judicial proceedings involving the registrant that arise under federal, state or local provisions that have the primary purpose of protecting the environment.

This disclosure requirement is triggered if:

- the proceedings are material to the business or financial condition of the registrant
- the relief sought amounts to more than 10% of the registrant's current assets, or
- government sanctions would amount to more than US\$100,000.

Item 303

This item requires disclosures in the form of a management discussion and analysis (MD&A). This is a comparable notion to the operating and financial review, as found in s 299A and the UK legislation (see below), in that it has expanded the ambit of corporate annual reports to include forward-looking and non-financial information.

Paragraph (3)(ii) of this Item requires the MD&A to:

Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.

According to an SEC Press Release that accompanied an interpretive release on MD&A:

MD&A should not be merely a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements, neither of which provides the important management perspective called for by MD&A. Instead, the release encourages top-level management involvement in the drafting of MD&A, and provides

guidance regarding ... known material trends and uncertainties [and] key performance indicators, including non-financial indicators.¹⁸⁸

An EPA Enforcement Alert (October 2001) applies this requirement to environmental contingencies.

Voluntary agreements

From time to time, use has been made of voluntary reporting arrangements, based on agreements between government and industry. For instance, an environmental co-operative agreement, signed in February 2001 in Wisconsin between a private utility and the Wisconsin Department of Natural Resources, requires the private utility:

to prepare an annual environmental performance report in accordance with [the GRI *Sustainability Reporting Guidelines*]. As part of the agreement, [the private utility] must demonstrate measurable improvements in environmental performance, implement an environmental management system and expand its stakeholder involvement program. In exchange, [the private utility] will benefit through permit streamlining, alternative monitoring and more flexible operations.

4.5.2 European Union

Starting in the 1990s, various EU countries introduced obligations on companies within their jurisdiction to include in their annual reports information about the environmental and social impact of their activities and the ways in which they managed that impact.¹⁸⁹

In May 2001, the EU Commission issued a recommendation on the recognition, measurement and disclosure of environmental matters in the annual reports and accounts of EU companies. It noted that:

the lack of explicit rules has contributed to a situation where different stakeholders, including regulatory

¹⁸⁸ SEC Press Release 2003-179 (19 December 2003).

¹⁸⁹ For instance, Denmark mandated public environmental reporting in its 'Green Accounting Law' in 1995, requiring over 3000 Danish companies to publish a 'Green Account' describing their impact on the environment and the way in which they manage this impact. The Netherlands and Norway also enacted similar legislation affecting their largest companies.

authorities, investors, financial analysts and the public in general may consider the environmental information disclosed by companies to be either inadequate or unreliable. Investors need to know how companies deal with environmental issues. Regulatory authorities have an interest in monitoring the application of environmental regulations and the associated costs.¹⁹⁰

The Commission observed that:

... there is a justified need to facilitate further harmonisation on what to disclose in the annual accounts and annual reports of enterprises in the European Union as far as environmental matters are concerned. The quantity, transparency and comparability of environmental data flowing through the annual accounts and annual reports of companies must also be increased.¹⁹¹

This proposal provided the context for the *EU Accounts Modernisation Directive* (June 2003), which included expanded reporting obligations of EU corporations, going beyond the financial, to the environmental and social, aspects of their operations.¹⁹² This Directive, which deals with various matters relating to annual reports and consolidated accounts, states that:

The information [in the annual report] should not be restricted to the financial aspects of the company's business. It is expected that, where appropriate, this should lead to an analysis of environmental and social aspects necessary for an understanding of the company's development, performance or position.¹⁹³

The Directive includes a requirement for large and medium EU companies to provide the following information in their annual reports for financial years commencing on or after 1 January 2005:

The annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces.

¹⁹⁰ EU Commission Recommendation 30 May 2001 (2001/453/EC) at (4).

¹⁹¹ *id* at (10).

¹⁹² Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003.

¹⁹³ *id* at (9).

The review shall be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business.

To the extent necessary 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.¹⁹⁴

The *EU Accounts Modernisation Directive* sets minimum mandatory standards for EU countries. France had previously enacted legislation that included requirements consistent with, though going beyond, the subsequent Directive. Germany is representative of those EU countries that have passed legislation closely following the language of the EU Directive. The United Kingdom has enacted more comprehensive provisions.

4.5.3 United Kingdom

There has been a range of initiatives concerning social and environmental reporting, beginning in the 1990s. The UK Accounting Standards Board in 1993 issued a statement of voluntary best practice for non-financial risk disclosure in annual reports, followed by the Turnbull Report (1999), issued by the Institute of Chartered Accountant in England and Wales, concerning the disclosure of environmental and other risks. This impetus was reinforced by the Association of British Insurers releasing in 2001 a set of voluntary guidelines for companies to disclose in their annual

¹⁹⁴ Directive 78/660/EEC, Article 46(1)(a), (b) as amended by Directive 2003/51/EC, Article 1.14(a).

reports social, ethical and environmental risks and opportunities, and how they are managed.¹⁹⁵

This focus on non-financial reporting has now been adopted in the UK Companies Act through the introduction of requirements in annual reports for an operating and financial review (OFR) or an enhanced directors' report. These requirements implement, but also go beyond, the requirements in the *EU Accounts Modernisation Directive*.

Operating and financial review

Directors of quoted companies¹⁹⁶ must prepare an annual OFR for financial years beginning on or after 1 April 2005.¹⁹⁷ This amendment to the UK Companies Act is the culmination of a government-initiated review process over a number of years.¹⁹⁸

¹⁹⁵ The Association of British Insurers report, *Risk Returns and Responsibility* (2004) provides a useful summary of these voluntary guidelines. These guidelines deal with companies including in their annual report information about any significant social, environmental or ethical (SEE) matters relevant to the business of the company, any SEE-related risks or opportunities arising therefrom, including their effect on the company's short-term and long-term value, and how the company is managing those matters. Initially, it took companies some time to adopt these guidelines: *Sustainability, Governance, Risk and Corporate Social Responsibility* (October 2001). However, the 2004 *Risk Returns and Responsibility* report stated that 80 of the top 100 of the UK's largest companies provided modest to full non-financial risk disclosure, though there was a much weaker commitment among the second-tier public companies.

¹⁹⁶ These are UK-incorporated companies that are listed on the London Stock Exchange or various other designated exchanges.

¹⁹⁷ Companies Act 1985 (UK) (Companies Act) ss 234AA, 234AB. The OFR must be approved by the board of directors and comply with Schedule 7A. Subsection 234AA(3) requires a consolidated OFR for corporate groups.

¹⁹⁸ The Company Law Review (CLR), in its report *Modern Company Law for a Competitive Economy* (July 2001), noted that while many companies voluntarily included an OFR, the content of these reports varied widely. The CLR recommended that companies of significant economic size should be required to prepare and publish an OFR as part of their annual report and accounts. This recommendation was supported by the UK Department of Trade and Industry White Paper *Modernising Company Law* (July 2002), which proposed the introduction of an OFR, including disclosure of environmental and other risks. In 2003–2004, the UK government, through the OFR Working Committee, conducted a consultation process, as reflected in *The Operating and Financial Review Working Group on Materiality* (2003), concerning the introduction of a statutory OFR. The amendments to the Companies Act to require an OFR have been in force since April 2005.

According to the Guidance accompanying the legislation, the purpose of the OFR is to require companies to disclose information on a range of qualitative and forward-looking factors that are relevant to the business of a company, but that have traditionally not been included in financial statements or annual reports. It is designed to provide investors, financial analysts and other interested parties with a longer term and broader view of a company's strategy, risks, uncertainties and opportunities, as well as past performance and opportunities:

The purpose of the OFR is to assist shareholders assess a company's strategies and the potential for them to succeed. It will assist shareholders to make an assessment not only of the company's past performance, but also of the directors' view on its future prospects. 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.¹⁹⁹

To achieve this, the legislation provides that the OFR must include a balanced and comprehensive analysis, consistent with the size and complexity of the business, of:

- the development and performance of the business of the company during the financial year
- the position of the company at the end of the year
- the main trends and factors underlying the development, performance and position of the business of the company during the financial year, and
- the main trends and factors which are likely to affect the company's future development, performance and position

¹⁹⁹ *Guidance on the OFR and changes to the directors' report* (April 2005) at 7. This reflects the view in the UK Department of Trade and Industry paper *Company Law Reform* (March 2005) (at 10) that operators of successful companies need to develop relationships and provide greater information transparency to key stakeholders such as employees, customers, suppliers and others in the broader community.

and prepared so as to assist the members of the company to assess the strategies adopted by the company and the potential for those strategies to succeed.²⁰⁰

The legislation also requires that the OFR include:

- a statement of the business, objectives and strategies of the company²⁰¹
- a description of the resources available to the company²⁰²
- a description of the principal risks and uncertainties facing the company,²⁰³ and
- a description of the capital structure, the treasury policies and objectives and the liquidity of the company²⁰⁴

and, to the extent necessary to comply with any of the above requirements, information about:

- environmental matters (including the impact of the business of the company on the environment)
- the company's employees, and
- social and community issues.²⁰⁵

The legislation further requires that the OFR include:

- the policies of the company in each of these three areas (environmental matters, employees and social and community issues) and the extent to which they have been successfully implemented.²⁰⁶ If the OFR does not contain information and analysis on each of these matters, it must so indicate²⁰⁷

²⁰⁰ UK Companies Act 1985 Schedule 7ZA para 1.

²⁰¹ Schedule 7ZA para 2(a).

²⁰² Schedule 7ZA para 2(b).

²⁰³ Schedule 7ZA para 2(c). The language of this requirement makes clear that the purpose of internal controls is to manage and control risk in an appropriate manner, rather than necessarily eliminate it.

²⁰⁴ Schedule 7ZA para 2(d).

²⁰⁵ Schedule 7ZA para 4(1).

²⁰⁶ Schedule 7ZA para 4(2).

²⁰⁷ Schedule 7ZA para 3(2).

- analysis using financial and, where appropriate, other key performance indicators, including information relating to environmental matters and employee matters.²⁰⁸ (To assist this process, the UK Government has identified environmental key performance indicators to guide companies in these reporting obligations.²⁰⁹)

The legislation recognises that directors will need to make judgments about what data and analysis to include and the level of detail to which it is appropriate to go.²¹⁰ Where directors consider that there is nothing to say on one or more of these issues, they must make a positive statement to this effect, though they are not required to explain how they have arrived at their decision.²¹¹ Any director who intentionally or recklessly breaches the OFR requirements in this or any other respect is guilty of an offence.²¹²

The UK Accounting Standards Board, which has responsibility for issuing standards to guide the implementation of the OFR requirements, has stated that the OFR should:

include information about significant relationships with stakeholders other than members, which are likely, directly or indirectly, to influence the performance of the business and its value. Directors, in deciding what shall be included in the OFR, will need to take a broad view in considering the extent to which the actions of stakeholders other than members can affect an entity's performance and thus its value. For example, for many entities, relationships with customers, suppliers, employees, contractors, lenders, creditors and regulators will be important, as will the entity's broader impact on society and the communities affected by its activities.²¹³

The OFR is subject to limited external audit. Auditors must certify whether, in their opinion:

²⁰⁸ Schedule 7ZA para 6.

²⁰⁹ UK Department for Environment, Food and Rural Affairs, *Environmental Key Performance Indicators: Reporting Guidelines for UK Business* (2005).

²¹⁰ Schedule 7ZA para 3(1).

²¹¹ Schedule 7ZA para 3(2).

²¹² s 234AA(5).

²¹³ UK Accounting Standards Board Reporting Standard 1 *Operating and Financial Review* (May 2005), paras 59–60.

- the information given in an OFR is consistent with the company's accounts, and
- any other matters that have come to their attention in the performance of their functions are inconsistent with information directors have given in the OFR.²¹⁴

However, auditors are not required to state whether the OFR presents a true and fair view of the company's position or whether (as was initially proposed) the directors have prepared the OFR 'after due and careful inquiry'.²¹⁵

Directors' report

Directors of large and medium sized non-quoted UK companies must include a directors' report in their annual report, for financial years beginning on or after 1 April 2005.²¹⁶ That report must contain a business review that includes:

- a description of the principal risks and uncertainties facing the company,²¹⁷ and
- an analysis of the development and performance of the business of the company during the financial year.²¹⁸ That information, where appropriate, must include information 'relating to environmental matters and employee matters'.²¹⁹

This business review is similar to the OFR in placing increased focus on non-financial information. However, it does not need to include the same type of forward-looking information, such as information on strategies and longer term policies, that is required in the OFR.

²¹⁴ s 235(3A).

²¹⁵ Professor P Davies, 'Enlightened Shareholder Value and the New Responsibilities', WE Hearn Lecture at the University of Melbourne Law School, 4 October 2005.

²¹⁶ s 234. Subsection 234(2) requires a consolidated group directors' report.

²¹⁷ s 234ZZB(1)(b).

²¹⁸ s 234ZZB(2)(a).

²¹⁹ s 234ZZB(3)(b).

Any director who intentionally or recklessly breaches the directors' report requirements is guilty of an offence.²²⁰

Auditors are required to state in their report whether, in their opinion, the information given in a directors' report is consistent with the company's accounts.²²¹

4.5.4 France

France was the first country to mandate triple bottom line reporting for publicly listed companies. These requirements are consistent with, though go beyond, the *EU Accounts Modernisation Directive*.

Legislation enacted in 2001, and operative from 2003,²²² requires all French companies listed on the 'premier marché' (those with largest market capitalisation) to include in their annual reports 'information on how the company takes into account the social and environmental consequences of its activities'.

Other legislation²²³ established various corporate sustainability reporting indicators, including human resources,²²⁴ community issues and engagement,²²⁵ labour standards²²⁶ and the environmental impact of corporate activities.²²⁷

²²⁰ s 234(5).

²²¹ s 235(3).

²²² *Nouvelles Régulations Économiques* (No 2001-420).

²²³ Assemblée Nationale Decree No 2002-221.

²²⁴ These include detailed information relevant to total workforce, including working hours, industrial relations and health and safety conditions.

²²⁵ These include how corporations take into account the impact of their activities on local development and local populations and how they engage with local stakeholder groups, including environmental NGOs, consumer groups, educational institutions and local communities.

²²⁶ These include how the international subsidiaries of corporations respect the International Labour Organization (ILO) core labour conventions and how the corporations promote the ILO conventions in relation to their international subcontractors.

²²⁷ These include energy use and efficiency, biological damage and protection, conformity with legal obligations, expenditures to prevent the consequences of any detrimental corporate activity on the environment and information concerning environmental risks and any compensation paid for environmental damage.

4.5.5 Germany

The principles in the *EU Accounts Modernisation Directive* apply to annual reports for larger German companies for financial years beginning on or after 1 January 2005. The German law closely reflects the wording in that Directive.²²⁸

The explanatory statement accompanying this legislation pointed out that the requirements to include environmental and employee matters are not exhaustive. German companies must also include other non-financial key performance indicators in their annual reports, so far as they are important for an understanding of the company's current and future position. These indicators could encompass, for instance, a company's relationship with its customer base and its broader social reputation, as may be promoted through its philanthropic activities.²²⁹

4.5.6 South Africa

Companies listed on the Johannesburg Stock Exchange (JSE), and some other entities, have been required since 2003 to report annually on their social and environmental performance using the Global Reporting Initiative (GRI) as a framework.

This requirement follows from the second King Report into corporate governance (King II).²³⁰ That report contained a Code of Corporate Practices and Conduct which applies to companies with securities listed on the JSE.²³¹ In the section headed 'Integrated Sustainability Reporting', the Code states that:

Every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. The board must determine what is relevant

²²⁸ Handelsgesetzbuch (the German Commercial Code) §289, as amended by the Bilanzrechtsreformgesetz (Accounting Law Reform Act) (2004).

²²⁹ These requirements are also reflected in German Accounting Standard 15, which emphasises the importance of including qualitative as well as quantifiable information in annual reports.

²³⁰ King Committee on Corporate Governance, *King Report on Corporate Governance in South Africa 2002* (King II) (March 2002).

²³¹ Code of Corporate Practices and Conduct, King II, 1.1.1.

for disclosure, having regard to the company's particular circumstances.²³²

It goes on to stipulate that the GRI is to be used as the 'framework for such reporting':

disclosure of non-financial information [in the report 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).²³³

The JSE created the 'SRI Index' as a means to identify those corporations listed on the JSE that integrate the principles of SRI and sustainability into their business activities, and as a way of increasing compliance with the King II recommendations. Companies must meet criteria to be included in the index, and they are then scored according to their level of adoption and implementation.

4.5.7 Canada

Reporting entities in Canada have various disclosure obligations, including annual financial statements and management discussion and analysis (MD&A).

Financial statements must include the effect of any environmental exposures that materially impair the value of assets or create material obligations or contingent liabilities. These statements must also include other transactions that give rise to material assets or liabilities, such as transactions related to greenhouse gas emissions.

The MD&A, a document prepared by management to complement the financial statements, provides an overview of factors contributing to financial performance in the current period, as well as an outlook of prospects for future performance. In filing the MD&A, companies are expected to discuss 'commitments, events, risks, or uncertainties' that could materially affect future performance. The Guidance from the Canadian Institute of Chartered Accountants (CICA) for the MD&A suggests that social and

²³² Code of Corporate Practices and Conduct, King II, 5.1.1.

²³³ Code of Corporate Practices and Conduct, King II, 5.1.3.

environmental issues are examples of risks that could materially affect a company's future performance.²³⁴

A recent proposed guidance note by CICA with respect to environmental issues goes further by suggesting to MD&A preparers that:

climate change and other environmental issues should be disclosed and discussed if they either have, or are reasonably likely to have, a current or future effect, direct or indirect, on the entity's financial condition, changes in financial condition, results of operations, liquidity, capital expenditures or capital resources that is material to investors. In considering what might be material to investors, management should consider potential impacts of environmental issues on intangibles, such as corporate reputation, brand loyalty and key stakeholder relationships.²³⁵

4.6 International developments

The International Accounting Standards Board has published a discussion paper, *Management Commentary* (October 2005), which reviews whether the management commentary that accompanies financial statements should be expanded to include, for instance, matters comparable to those found in the UK operating and financial review.²³⁶

4.7 Appropriate categorisation of companies for reporting purposes

The current corporate reporting requirements in Australia and overseas are typically linked to features of the companies themselves, such as their size or whether they are listed. For instance, the enhanced reporting requirements in s 299A apply only to listed companies, while the OFR/directors' reporting requirements in the United Kingdom cover all companies other than smaller

²³⁴ *MD&A Guidance* issued by the CICA in 2002 and revised in 2004.

²³⁵ CICA Interpretative Release, *Disclosing the Financial Impact of Climate Change and Other Environmental Issues* (March 2005).

²³⁶ The International Accounting Standards Board has called for submissions by 28 April 2006.

non-quoted companies. The *EU Accounts Modernisation Directive* applies to large and medium EU companies, while the South African enhanced reporting requirements focus primarily on listed entities.

On one view, there may be a public interest in requiring disclosure by any entity whose activities have a significant environmental or social impact, regardless of its corporate categorisation. For instance, while the fact that a company is publicly listed may be a relevant criterion for requiring disclosure of information for the benefit of investors, to what extent does such a criterion meet the reasonable information requirements of other stakeholders?

4.8 Request for submissions

The Advisory Committee invites you to forward submissions on any aspect of Question 4 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?

In so doing, you may wish to respond to one or more of the following questions:

- 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
- would an additional environmental or social ‘impact’ reporting obligation be appropriate and feasible and, if so, how might it be stated?

5 Encouraging responsible business practices

The Advisory Committee has been asked to consider whether further steps are necessary to encourage Australian companies to adopt socially and environmentally responsible business practices and, if so, by what means. This chapter reviews a range of voluntary industry and market initiatives, as well as government measures that have been taken in particular jurisdictions and go beyond legislative prescription of directors' duties or corporate conduct.

5.1 Role of voluntary initiatives

There is already a good deal of activity in the marketplace, including action by individual companies to place more emphasis on social and environmental practice and reporting, in addition to initiatives by industry groups, NGOs and others to develop codes of practice and other measures. Various companies and bodies may see an opportunity to do more in this area, having regard to changing community awareness or in response to the expressed concerns of affected stakeholders or other interest groups.

In considering whether further steps are necessary or useful, it is relevant to take into account current voluntary initiatives, including:

- industry initiatives
- market initiatives
- joint government-industry initiatives
- educational initiatives
- government initiatives.

Voluntary initiatives can:

- be expeditiously implemented
- avoid the need for regulatory costs associated with obligatory provisions
- be adaptable to the circumstances of particular organizations
- attract industry support if based on consensus
- utilise peer pressure and competitive advantage to foster their use
- be used as indicators of overall management competence.

However, voluntary initiatives by their nature lack sanctions, other than peer or market pressure.

5.2 Industry initiatives

5.2.1 Australia

Apart from the initiatives of individual companies, a range of self-regulatory codes of conduct has been developed at an industry level. In the Australian context, these include:

- the *Australian Minerals Industry Framework for Sustainable Development*, a voluntary code established by the Australian Minerals Industry to encourage Australian mining companies to improve their environmental performance beyond regulatory compliance, including through the preparation of an annual report on environmental management²³⁷
- the *Mining Certification Evaluation Project*, being a research project involving representatives from mining companies, industry and non-government organizations to test the feasibility of introducing a social and environmental certification scheme for mine sites.

²³⁷ Minerals Council of Australia, *Enduring Value: The Australian Minerals Industry Framework for Sustainable Development* (2004).

5.2.2 International

Various industry or investor bodies have sought to develop internationally recognised voluntary guidelines.²³⁸ Examples include:

- the *Caux Principles* for ethical and responsible corporate behaviour, sponsored by senior business leaders from Europe, Japan and North America
- the *Greenhouse Gas Protocol Initiative*, containing internationally accepted accounting and reporting standards in relation to greenhouse gas emissions
- the *Global Sullivan Principles* on labour, business ethics and environmental practices of multinational companies
- the *Business Charter for Sustainable Development*, designed by the International Chamber of Commerce to encourage corporations to improve their environmental results
- the *Carbon Disclosure Project*, under which major global institutional investors request information from the largest corporations in the world concerning their greenhouse gas emissions and the extent to which they have integrated fossil fuel risk into their operations²³⁹
- the *Equator Principles*, under which financial institutions agree that major projects they finance will be developed in a socially responsible manner that reflects sound environmental

²³⁸ A comprehensive list of relevant codes and guidelines is found in K McKague & W Cragg, *Compendium of Ethics Codes and Instruments of Corporate Responsibility* (September 2005). See also R Goel & W Cragg, *Guide to instruments of corporate responsibility* (October 2005).

²³⁹ In February 2005, a letter signed by 143 institutional investors with assets of over \$20 trillion was sent to the FT500 largest companies in the world asking them how they are addressing climate change. This is the third version of the letter, the first having been signed some years ago by 35 institutional investors representing \$4.5 trillion in assets.

management practices.²⁴⁰ A similar initiative is the *United Nations Environment Programme Finance Initiative*, a partnership between the UN and the private financial sector

- the *Extractive Industries Transparency Initiative*, which aims to increase transparency concerning payments by companies to governments and government-linked entities, as well as transparency concerning revenues by host country governments.

Some of these initiatives have been developed through forums involving a range of stakeholder groups, not just representatives of the industry sector.

5.3 Market initiatives

5.3.1 ASX Corporate Governance Council

As noted earlier in this paper, the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* 7 and 10 set out voluntary standards of corporate behaviour for Australian listed entities that include environmental and social factors.

Also, the Government has asked the ASX Corporate Governance Council to consider introducing sustainability reporting into its *Principles of Good Corporate Governance and Best Practice Recommendations*, on the same voluntary 'if not, why not' reporting basis as the existing principles.²⁴¹

²⁴⁰ The Equator Principles are based on social and environmental policies of the World Bank and the International Finance Corporation. See also World Bank Group, *Strengthening Implementation of Corporate Social Responsibility in Global Supply Chains* (October 2003). As of mid-2005, the Equator Principles have been adopted by 30 of the largest international banks, which apply them to all project financing with a capital cost of some US\$50 million or more.

²⁴¹ This request has come from the Minister for the Environment and Heritage, Senator the Hon. Ian Campbell, as referred to in the *Department of the Environment and Heritage Submission to the PJC Inquiry on Corporate Social Responsibility* (Submission 116).

5.3.2 Standards Australia

Standards Australia has published *Standard 8003-2003 Corporate social responsibility*, comparable to the ASX Corporate Governance Council principles, but aimed at non-listed companies and not-for-profit organizations.

That voluntary standard, like the ASX guidelines, is intended as a guide for a self-regulatory approach. Each entity using the standard should 'have adequate engagement with its stakeholders on its environmental and social impact'.

Relevant issues identified by the standard include:

- employee issues, including unreasonable disciplinary practices and working hours, freedom of association, discrimination, child labour and forced labour
- environmental issues
- health and safety.

The standard recommends that a company's compliance with the standard be subject to some form of independent third party verification, not necessarily amounting to an independent audit.

5.3.3 Market indices

The Australian *Corporate Responsibility Index* is a voluntary self-assessment managerial tool to enhance the capacity of businesses to develop, measure and communicate socially and environmentally responsible corporate conduct. It has been adopted by some ASX-listed companies.²⁴²

²⁴² Results of the latest annual survey of participating companies were reported in the *Sydney Morning Herald* and the *Age* on Monday 4 April 2005. The index is made up of four components that require participating companies to show how they have dealt with environmental and social issues:

- *corporate strategy*: companies are asked to identify their corporate values in relation to four key areas of corporate responsibility—community, environment, workplace and marketplace. Companies have to demonstrate who has responsibility for these areas at a senior executive level and how they are linked to their overall corporate strategy, risk management and policies

Other indices developed in Australia include the SAM Sustainability Index and the RepuTex SRI Index.

5.3.4 Overseas exchanges and indices

The Dow Jones Sustainability Index, established in 1999, comprises the top 200 global companies that satisfy certain criteria on environmental protection, sustainability, social issues, stakeholder relations and human rights.

The London Stock Exchange in 2001 established a separate 'FTSE4Good' index, which measures the performance of companies that meet globally recognised environmental and social standards. To overcome duplication involved in companies meeting the information requirements from a multiplicity of research organizations, the Exchange also established the Corporate Responsibility Exchange (CRE), which is a mechanism for companies to publish on-line environmental and social performance information. The CRE is designed to give investors, research agencies and other interested parties a single site where they can access and analyse this information.

The Johannesburg Securities Exchange in 2003 created an 'SRI Index', designed to identify those corporations listed on that Exchange that have adopted social reporting and sustainability principles in their business activities. The Jantzi Social Index has been developed in Canada.

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- *integration*: this highlights how effectively a company has translated its corporate strategy into mainstream management practice
 - *management*: participants must identify the key community, environmental, marketplace and workplace issues (risks and opportunities) that are material to their businesses. They must show how these issues are addressed through the setting of objectives, targets and stakeholder engagement and how they are monitored and communicated
 - *performance and impact*: participants must choose two environmental impacts, two social impacts and two other impacts—social or environmental—and link these to material issues identified in the management component.

5.4 Joint government-industry initiatives

5.4.1 Prime Minister's Community Business Partnership

In February 1998, the Prime Minister, the Hon. John Howard MP, convened a Corporate Philanthropy Roundtable to promote increased collaboration between business and community groups through the concept of a 'social coalition'.

The Roundtable later became the Prime Minister's Community Business Partnership. This partnership is a group of prominent Australians from the community and business sectors, appointed by the Prime Minister to advise and assist the Government on issues concerning community-business collaboration.

The Partnership's goals include identifying and addressing incentives and impediments to corporate social responsibility in Australia. Its role includes advocacy, facilitation and recognition of corporate social responsibility and partnerships between business and community organizations in Australia. Initiatives of the Partnership include the 'Giving Australia' project, dealing with corporate philanthropy, and the annual Prime Minister's Awards for Excellence in Community Business Partnerships.²⁴³

5.4.2 Other initiatives

The Australian Government has initiated various voluntary arrangements with industry participants and others designed to respond to environmental and social concerns. They include:

- the Greenhouse Challenge, which focuses on reducing greenhouse gas emissions²⁴⁴
- Eco-efficiency Agreements, aimed at promoting eco-efficiency in industry²⁴⁵

²⁴³ Some private organizations, such as the Association of Chartered Certified Accountants, give awards for sustainability reporting to encourage better sustainability reporting and to serve an educational role. Other awards include the Australasian Reporting Awards and the Banksia Environmental Awards.

²⁴⁴ Australian Greenhouse Office, *About the Greenhouse Challenge*.

- the National Packaging Covenant, designed to reduce packaging and other waste.²⁴⁶

There are comparable initiatives at other government levels, including in relation to socially responsible investment.²⁴⁷

5.5 Educational initiatives

An increasing number of business schools worldwide are introducing corporate social responsibility subjects into the curriculum, such as ‘business ethics and corporate responsibility’, ‘business strategies for emerging markets’ and ‘corporate environmental management’.²⁴⁸ Similar initiatives have been

²⁴⁵ Department of the Environment and Heritage, *Eco-Efficiency Agreements*.

²⁴⁶ Department of the Environment and Heritage, *National Packaging Covenant*.

²⁴⁷ The Ethical Investment Association in Australia has launched a certification program for socially responsible investment. It uses an SRI symbol (in this context, standing for sustainable responsible investment), created in partnership with the New South Wales Department of Environment and Conservation and the Victorian Government. It aims to promote consistent, standardised disclosure and education about SRI.

Another initiative is through the *Environment Protection (Resource Efficiency) Act 2002* (Vic), which gives corporations the option of entering into voluntary covenants to decrease the ecological impact of their activities and increase their resource efficiency. See further J McConvill and M Joy, ‘The Interaction of Directors’ Duties and Sustainable Development in Australia: Setting Off on the Uncharted Road’ (2003) 27 *Melbourne University Law Review* 116 at 122–125.

²⁴⁸ According to the report *Beyond Grey Pinstripes* (World Resources Institute and the Aspen Institute, 2005), of the 91 business schools surveyed on 6 continents, 54% required a course in ethics, corporate social responsibility or business and society, up from 45% in 2003 and 34% in 2001. The report observed, however, that corporate social responsibility coursework tended not to be integrated across various disciplines:

For MBA students to be truly prepared for the challenges they will face as executives after graduation, these topics need to be integrated across the business-school curriculum and in other required courses such as accounting, economics, finance, information technology, marketing, operations and strategy.

undertaken to promote the inclusion of corporate social responsibility and sustainability issues in the curricula of Australian business schools.²⁴⁹

5.6 Government initiatives

5.6.1 Current initiatives

Legislative encouragement

The Corporations Act includes a provision that encourages product issuers to assess the environmental and social aspects of particular companies in the context of offering certain investment products to investors.²⁵⁰

The Global Responsibility Initiative is an example of corporations and business schools coming together under the joint auspices of the UN Global Compact and the European Foundation for Management Development in a program to examine the links between business education and corporate practice. The group is comprised of 21 global businesses and business schools. This group is to examine and make recommendations (1) to offer tangible direction on how to mainstream the teaching of global corporate citizenship into the curricula of business schools; (2) to offer tangible direction on how to mainstream the practice of global corporate citizenship into the practice of global corporations; and (3) to offer a new business model that provides a vision to help train business leaders whereby global corporate citizenship becomes a pillar of such leadership.

²⁴⁹ D Tilbury, C Crawley and F Berry (2004), *Education About and For Sustainability in Australian Business Schools*. This report was prepared for the Department of the Environment and Heritage by the Australian Research Institute in Education for Sustainability (ARIES) and Arup Sustainability. Recent initiatives referred to in that report are summarised in the *Department of the Environment and Heritage Submission to the PJC Inquiry on Corporate Social Responsibility* (Submission 116).

²⁵⁰ The Corporations Act s 1013D(1)(l), introduced in 2002, requires product issuers, if offering a financial product with an investment component (as explained in s 1013D(2A)), to disclose in their product disclosure statements the extent to which they take into account labour standards, or environmental, social or ethical considerations in their selection, retention or realisation of the investment. Product issuers must state that they do not take these standards and considerations into account, if that is the case (Corporations Regulations reg 7.9.14C).

International agreements

In accordance with the OECD *Guidelines for multinational enterprises*, the Australian Government has established a National Contact Point to handle enquiries about, and otherwise promote, those guidelines.²⁵¹

Government agencies promoting responsible practices

Some Australian public sector bodies have been involved in developing methodologies to assist entities that choose to adopt the Global Reporting Initiative principles²⁵² and have prepared their own reports based on those principles.²⁵³ They have also provided public information on the state of the environment²⁵⁴ and have sponsored research and information documents.²⁵⁵

5.6.2 Other possible initiatives

Governments have various ways in which they can provide incentives or otherwise encourage particular forms of corporate behaviour, including through:

- tailoring conditions in their procurement and tendering policies
- requiring participants in public-private partnerships to demonstrate that they follow appropriate business practices

²⁵¹ The Australian National Contact Point, established in 1991, is in the Foreign Investments Review Board, and also involves the Department of Treasury, as well as other Australian Government departments.

²⁵² Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (June 2003).

²⁵³ Department of the Environment and Heritage, *Triple Bottom Line Report 2003–04: Our environmental, social and economic performance* (September 2004), Department of Family and Community Services, *Our commitment to social, environmental and economic performance: triple bottom line report 2003–04* (October 2004). According to the *Department of the Environment and Heritage Submission to the PJC Inquiry on Corporate Social Responsibility* (Submission 116), ‘recent survey results indicate that at least 11 Australian Government Departments and Agencies intend to produce non-financial reports on performance in coming years’.

²⁵⁴ For instance, the National Pollutant Inventory, operating through the Department of the Environment and Heritage, provides free access to information on the types and amounts of pollutants being emitted.

²⁵⁵ For instance, *Corporate Sustainability—An Investor Perspective* (2003) (the Mays report), published by the Department of the Environment and Heritage.

- facilitating the ability of companies to compare their practices through exchange of information²⁵⁶
- funding appropriate empirical and other research
- taxation or other fiscal measures.

A recent research paper also proposes some legislative initiatives in relation to socially responsible investing.²⁵⁷

The United Kingdom and France have established ministries to promote responsible corporate conduct.²⁵⁸ The UK policy framework comprises legislative²⁵⁹ and fiscal measures,²⁶⁰ funding of research,²⁶¹ fostering collaborations with different private enterprise sectors to develop programs,²⁶² and strategies,²⁶³ establishment of a

²⁵⁶ An example is Strategis, a website established by the Canadian Government to assist in the exchange of information and ideas, including those related to corporate social responsibility.

²⁵⁷ The report by the University of Technology Sydney, Institute for Sustainable Futures, *Mainstreaming SRI: A role for Government?* (November 2005) indicated that the policy options that received the most support from finance industry professionals and stakeholders surveyed were:

- requiring financial planners to ask potential customers if they are interested in SRI investing
- mandatory sustainability reporting for the top 200 ASX companies
- applying SRI to the Australian Government Future Fund, and
- requiring all superannuation funds to offer an SRI option.

²⁵⁸ The portfolio of the UK Corporate Social Responsibility Minister is within the UK Department of Trade and Industry.

²⁵⁹ See the legislative proposals in section 3.3 *Elaborated shareholder benefit approach* and the legislative amendments in section 4.5.3 *Operating and financial review*.

²⁶⁰ The UK 'Community Investment Tax Relief' (CITR) Scheme awards tax relief to individuals and corporate bodies investing in accredited community development finance institutions, which in turn provide finance to qualifying profit-distributing enterprises, social enterprises and community projects.

²⁶¹ The UK Government funds Emerging Market Economics, designed to develop sectoral reporting guidelines to provide a more comprehensive picture of the effect that companies have on poverty in various countries.

²⁶² The UK 'PharmaFutures' project brings together pension fund managers in the pharmaceutical sector to examine the sustainability of existing business models. The 'Under Served Market Project' examines possible partnerships between retail and property sectors and community groups to generate private sector investment in deprived neighbourhoods.

Corporate Social Responsibility Academy, adoption of sustainable procurement policy practices in government, and undertaking a range of awareness raising activities. The UK Government's strategy incorporates activities at the international organizational level²⁶⁴ and initiatives to 'foster continuous improvement in the economic, social and environmental impacts of UK companies operating outside the UK'.²⁶⁵ In March 2005, the UK Government published *Securing the Future—the UK Government Sustainable Development Strategy*, which set out broad policy goals through to 2020.²⁶⁶

5.7 Request for submissions

The Advisory Committee invites you to forward submissions on any aspect of Question 3 in the terms of reference, namely:

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

In so doing, you may wish to respond to one or more of the following questions:

- 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

The UK Department of Trade and Industry also supported the SIGMA project (Sustainability—Integrated Guidelines for Management), established in 2003. This is a partnership between the British Standards Institution (the leading UK standards organization), Forum for the Future (a leading sustainability charity and policy organization) and AccountAbility (a UK-based professional body for accountability).

²⁶³ In the UK, a 'business broker' program has been developed to support 'local strategic partnerships' between public sector organizations, businesses and community groups. An example is the 'Pioneer Group' program.

²⁶⁴ This includes the UK Government supporting international initiatives such as the OECD Guidelines for Multinational Enterprises and the UN Global Compact.

²⁶⁵ *Corporate Social Responsibility: An International Strategic Framework*.

²⁶⁶ The paper states that the Government 'has a key role to play in developing the business case for sustainable consumption and production—for instance, through standards, economic incentives, regulation, voluntary agreements, business support programs, communications and consumer policy'.

- 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?