

Corporate Social Responsibility

February 2006

James Hardie Special Commission of Inquiry

Early in 2004 the NSW Government established a Special Commission of Inquiry to examine the circumstances surrounding the establishment of the Medical Research and Compensation Foundation by the James Hardie group of companies.

The circumstances considered by the James Hardie Special Commission of Inquiry highlighted the fact that some Australian directors believe that they are required to act solely in the interests of their shareholders.

The findings of the James Hardie Special Commission of Inquiry, and the circumstances surrounding the Inquiry, are extremely important to the NSW Government. The NSW Government would like to ensure that these circumstances do not arise again in the future. We are eager to ensure that all necessary amendments to the *Corporations Act* 2001, arising out of the Inquiry's final report, are progressed as quickly as possible.

The James Hardie experience illustrates that reform is required

James Hardie's directors claimed, at least initially, that they were unable to contribute funds to meet the liabilities of their former subsidiaries because of their duties to their shareholders. It was submitted that using company profits to compensate asbestos victims could have exposed the directors of James Hardie to a class action by its shareholders.

Directors' duties must be clear. Company directors, in controlling the actions of the company, must not make their decisions in a vacuum, motivated solely by profit. The community expects that company directors will consider the public interest in making their decisions. The law must clearly state that directors are able to do this.

It may be that the James Hardie interpretation of directors' duties provisions was not supported by the law. The Australian Institute of Company Directors (AICD), as well as the Business Council of Australia, rejected James Hardie's argument that their directors would have breached their duties to shareholders by authorising compensation of the asbestos victims.

However it is concerning that such a misinterpretation of directors' duties was made by officers of an ASX top 200 company. The fact that such a misinterpretation was made is especially concerning considering the efforts organisations such as the AICD and the ASX have made to promote the law and good corporate governance.

Reform of Australian law is necessary to clarify that the James Hardie interpretation of directors' duties is not the current law. Some directors may still adhere to the interpretation adopted by James Hardie. The fact that directors are not bound to act solely in the interests of shareholders must be placed beyond all doubt.

Reform must involve legislative change

The AICD has observed that many listed companies now have codes of conduct which recognise, "that to act in the best interest of the company, they must take into account the interests of other stakeholders, including employees, customers, the environment and communities affected by the company's activities."¹

Over the course of this Inquiry CAMAC may receive submissions which suggest that legislative reform is not required, that voluntary initiatives to enhance corporate social responsibility in Australia would sufficiently address this issue.

However, the circumstances which were considered by the James Hardie Special Commission of Inquiry provide clear evidence that codes of conduct and other voluntary initiatives would not ensure that the appropriate standards of corporate social responsibility are adhered to by all directors.

I believe that prudent directors already consider broader interests in performing their duties. I do not suggest that we need legislative reforms to change the behaviour of prudent directors. However reform is necessary to compel directors, who may not always follow prudent practices, to adhere to appropriate standards of corporate social responsibility. Voluntary reforms or directors' education initiatives may be effective in enhancing the behaviour of prudent directors, but they will not be effective in regulating all directors. Legislative reform is required.

Options for legislative reform

A number of suggestions for legislative reform have been raised with me on an informal basis.

These suggestions include reforms to clarify that:

- directors are able to consider broader interests;
- directors are able to, and in some circumstances would be remiss if they did not, consider broader interests; or
- while directors have a primary duty to act in the best interests of shareholders, in order to properly fulfil their duty to shareholders, directors should have regard to matters of public interest and the concerns of stakeholders.

Rather than imposing new duties on directors who currently perform their duties with due regard for the public interest, amendments to the Corporations Act could simply codify the existing practice of prudent company directors. Amendments

¹ AICD, Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility, 30 September 2005, at p.7.

need not substantively change the existing law. However, amendments should create a greater focus on corporate social responsibility in corporate decision making.

These broader interests, that directors could be required or permitted to consider, may include matters such as the company and its officers acting legally and ethically. It could involve the company ensuring that the legitimate expectations of its employees are considered. It could also involve the company minimising the negative impact, and maximising the positive impact, of the company's operations on the community, on minority groups and on the environment.

Whilst I remain open minded about the precise form that the amendments to directors' duties should take, I am convinced that reform is required and that this reform should be guided by some established, underlying issues.

These underlying issues include the need to remove incentives for directors to act solely in the interests of shareholders. They include the need to clarify that directors' sole motivation must not be the maximisation of profit for shareholders at the expense of the interests of the community. It must be clear that directors will fail in their duty to the company if they do not take relevant stakeholder interests into account.

As I have mentioned above, I am yet to be convinced on the precise formulation of directors' duties that is appropriate for introduction in Australia. However the circumstances considered by the James Hardie Special Commission of Inquiry make it clear that reform is necessary and that that reform must be directed towards a number of underlying issues, issues which have been highlighted by the James Hardie Inquiry. The recommendations that CAMAC must reach need to address these underlying issues.