

31 January, 2006

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

**Re: Inquiry into Corporate Social Responsibility**

Dear Executive Director,

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

Main arguments:

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

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

Sincerely,



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

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

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

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

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

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

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

<sup>2</sup> Gettler, L., "Enforced CSR would not work." The Age, 17/11/05.

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

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

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

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

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

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

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

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

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<sup>3</sup> Hughes, K., “Hardie inquiry finds legal failings.” The Age, 22/9/05.