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1 March 2006

Mr John Kluver  
Corporations and Markets Advisory Committee  
GPO Box 3967  
Sydney NSW 2001  
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Dear Sir

**DISCUSSION PAPER ON CORPORATE SOCIAL RESPONSIBILITY**

Thank you for the opportunity to make a submission on the Corporations and Markets Advisory Committee Discussion Paper November 2005 on Corporate Social Responsibility.

My submission relates to the following issues raised in the discussion paper:

- (a) *Paragraph 1.5:*
  - (i) *What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?*
- (b) *Paragraph 2.7:*
  - (i) *Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?*
- (c) *Paragraph 3.4:*
  - (i) *Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*
  - (ii) *Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

- (iii) *Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?*
- (d) *Paragraph 4.8:*
  - (i) *Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?*

### **Summary of submission**

In summary, my submission is that companies have an incentive to act in a socially responsible manner in order to avoid negative publicity, public outrage and condemnation, investor avoidance and a negative impact on their share price. Company directors are entitled to take into account the interest of stakeholders other than existing shareholders when exercising their duty to act in “the best interests of the corporation” and in certain circumstances may be obliged to do so. Acting socially responsibly is likely to result in positive publicity; public approval, endorsement and goodwill; investor confidence and demand; and resulting positive impact on the company share price. Thus it may be in the best interests of the corporation to act socially responsibly. Some minor amendment to the Corporations Act may be necessary for the purpose of clarifying this position. Existing ASX reporting requirements on the social and environmental impact of a company’s activities are sufficient, but if any further reporting requirements were to be imposed, the *ASX Principles of Good Corporate Governance and Best Practice Recommendations* provide an appropriate framework.

- (a) *Paragraph 1.5:*
  - (i) *What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?*

A strong incentive for companies to conduct their business in a socially responsible manner is the prospect of unfavourable publicity resulting from socially irresponsible behaviour. Even companies which are inclined to narrowly focus on achieving short-term benefits and profits for shareholders cannot afford to ignore the interests of other stakeholders.

The case of James Hardie is a good illustration of this point. As is well known, James Hardie sought to minimize its potential exposure to victims of asbestosis who would otherwise have had the right to claim compensation for injury and loss, by relocating overseas, using corporate quarantining and underfunding an established claim fund. The resulting publicity, public outcry and damage to James Hardie’s reputation and share price meant that it was essentially forced to enter into negotiations resulting in new arrangements aimed at providing proper compensation for the asbestosis victims.

The recent successes of “ethical investments” also illustrate the desire of sectors of the community to avoid investing in companies which are socially irresponsible.

Accordingly, there is an incentive for companies to act in a socially responsible manner in order to limit:

- (i) negative publicity;
- (ii) public outrage and condemnation;
- (iii) investor avoidance; and
- (iv) resulting negative impacts on the company share price.

Conversely, the benefits of acting socially responsibly are likely to be:

- (i) positive publicity;
- (ii) public approval, endorsement and goodwill;
- (iii) investor confidence and demand; and
- (iv) resulting positive impacts on the company share price.

**(b) Paragraph 2.7:**

- (i) ***Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?***

It is a fallacy that directors are obliged to focus only on the interests of existing shareholders of a company, with short-term considerations outweighing those more relevant to the long-term. Whilst the duty to act in “the best interests of the company”<sup>1</sup> requires directors to consider the interests of the company’s shareholders as a whole,<sup>2</sup> the interests of other stakeholders have always been relevant – in particular, the interests of creditors of the company must be given appropriate consideration in certain circumstances.<sup>3</sup> It is also clear that directors may act in a manner which is considered to be in the best interests of the company even though it may not be in the short-term interests of existing shareholders.<sup>4</sup> Overall, directors have flexibility to consider and balance short-term and long-term considerations when exercising their powers, so long as any decision that is made is in “the best interests of the company.”<sup>5</sup>

As noted above, a failure to act socially responsibly can have a significant impact on a corporation’s fortunes, with the risk of adverse publicity, public outrage, and investor avoidance. I suggest that this actually obliges directors properly taking into account “the best interests of the company”, to consider the interests of other stakeholders and the

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<sup>1</sup> See s181(1) *Corporations Act 2001* (Cth).

<sup>2</sup> See for example, *Greenhalgh v Ardene Cinemas Ltd* [1951] Ch 286.

<sup>3</sup> For example, if the company is proposing to engage in a share buy-back or capital reduction, or if the company is in financial difficulty.

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<sup>4</sup> See *Darvall v North Sydney Brick & Tile Co Ltd* (1988) 6 ACLC 154.

<sup>5</sup> For further academic discussion of this issue, see S Deakin, “The Coming Transformation of Shareholder Value” (2005) 13 *Corporate Governance: An International Review* 11; J McConvill, “Directors’ Duties to Stakeholders: A Reform Proposal Based on Three False Assumptions” (2005) 15 *Australian Journal of Corporate Law* 88.

potential impact upon the company of socially irresponsible behaviour. Directors who ignore the interests of other stakeholders now do so at their peril.

**(c) Paragraph 3.4:**

- (i) *Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?***

As is noted above, company directors are entitled to take into account the interests of stakeholders other than existing shareholders. The balancing act which is therefore necessitated when weighing up the often competing interests of different shareholders, does not readily lend itself to prescriptive rules and must lie within the discretion of directors. At most, to avoid the consequences of a mistaken belief that the interests of existing shareholders are always paramount, s181 Corporations Act could be amended to incorporate new inclusive provisions which are essentially “for the avoidance of doubt”:

*s181(3) A director or other officer of a corporation may take into account the interests of stakeholders other than the existing members of the corporation when determining whether an exercise of powers and discharge of duties is in the best interests of the corporation.*

*s181(4) Stakeholders of a corporation include existing shareholders, potential future shareholders, creditors of the corporation, employees of the corporation, customers and suppliers of the corporation, the environment and the broader community.*

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

As noted above, the balancing act which directors must undertake when weighing up the competing considerations of various stakeholders does not easily lend itself to prescriptive rules. So long as directors are bound to act in the best interests of the corporation and it is clear that the best interests of the corporation can include interests of stakeholders other than the existing shareholders, it is not necessary or desirable to place additional obligations on directors in this regard.

- (iii) *Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only?***

The amendment I have proposed to the Corporations Law, as set out above, is intended to be a clarification.

**(d) Paragraph 4.8:**

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

Australian companies listed on the Australian Stock Exchange are already subject to reporting requirements which can and do address the social and environmental impact of their activities. The ASX *Principles of Good Corporate Governance and Best Practice Recommendations* set out 10 good corporate governance principles, of which principle 10 provides that listed companies need to “recognize legal and other obligations to all legitimate stakeholders.” Listed companies are obliged to establish and disclose a Code of Conduct to guide compliance with those obligations, or to explain why they have not done so, in the company’s annual report. The suggested content of the code includes information about the company’s responsibilities to shareholders and the financial community generally; responsibilities to clients, customers and consumers; employment practices; and responsibilities to the community.

Due to the obligation on listed companies to act in accordance with these recommendations or explain why they have not done so, there is little option but to comply.<sup>6</sup> Accordingly, it is not necessary to impose any further reporting obligations on listed companies. If it was considered desirable to impose any further reporting obligations more specially related to these issues, the ASX recommendations would provide a useful framework within which that could occur.

Thank you for the opportunity to make a submission on the discussion paper.

Yours sincerely

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<sup>6</sup> See further J McConvill and J Bingham, “Comply or Comply: The Illusion of Voluntary Corporate Governance in Australia” (2004) 22 *Company and Securities Law Journal* 208.