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

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

a) Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions, and to require directors to take those interests into account?

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

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

At its most extreme, there is a view that

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

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

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

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

---

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

and that

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

[26] Corinne Proske, 'National Australia Bank Step Up Loan' (Paper presented at the Microcredit: More than just small change conference, Victoria, 10 June 2005)
[27] See for example Anz Bank, 'Our performance 2004: Making a sustainable contribution to society' (2004); Westpac Banking Corporation, 'Pressing On: 2004 Social Impact Report' (2004)
[28] See for example discussion in Sasha Courville, 'Social Accountability Audits: Challenging or defending Democratic Governance?' (2003) 25(3) *Law and Policy* 269
[29] Federal Financial Institutions Examination Council, *FFIEC web site* <http://www.ffiec.gov/hdma/history.htm> at 8 June 2004

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

Anz Bank, 'Our performance 2004: Making a sustainable contribution to society' (2004).

Ayres, Ian and Braithwaite, John, *Responsive Regulation: Transcending the Deregulation Debate* (1992).

Baldwin, Robert and Cave, Martin, *Understanding Regulation: Theory Strategy and Practice* (1999).

Chant Link & Associates, 'A Report on Financial Exclusion in Australia' (ANZ, 2004).

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

Cicutto, Frank, 'Community Link Speech Notes' (Paper presented at October 2000 2000).

Courville, Sasha, 'Social Accountability Audits: Challenging or defending Democratic Governance?' (2003) 25(3) *Law and Policy* 269.

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

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

Hall, John, 'The social responsibility of corporations' (2002) 27(1) *Alternative Law Journal* 12.

Parker, Christine, *The Open Corporation: Effective Self-Regulation and Democracy* (2002).

Parkinson, John, *Corporate Power and Responsibility* (1993).

Parliamentary Joint Committee on Corporations and Financial Services, 'Money Matters in the Bush: Inquiry into the Level of Banking and Financial Services in Rural, Regional and Remote Areas of Australia' (Commonwealth of Australia, 2004).

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

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

Reifner, Udo, *Micro-Lending- a Case for Regulation: General Report on the Regulation of Credit for Social Purposes by Non-Banks in the EU* (2005) <http://www.money-advice.net/media-php?id=225> at 7 July 2005.

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

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

Westpac, 'Westpac 2004 Stakeholder Impact Report' (2004).

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