



**Australian Government**  
**Corporations and Markets**  
**Advisory Committee**

# **THE SOCIAL RESPONSIBILITY OF CORPORATIONS**

## **Report**

**December**  
**2006**

Corporations and Markets **Advisory  
Committee**

The social responsibility  
of corporations

Report

**December 2006**

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1 December 2006

The Hon. Peter Costello, MP  
Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Treasurer

I am pleased to present a report by the Advisory Committee on *The social responsibility of corporations*.

The report was prepared in response to a request from the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP, in March 2005.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard St. John', written in a cursive style.

Richard St. John  
Convenor



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## Resolving the social responsibility conundrum

*The notion of corporate social responsibility is an elusive one. It raises questions of to whom and in what way companies are accountable. Heightened interest in the way that companies conduct their activities is understandable and is to be welcomed. At the same time, care needs to be taken in discerning various viewpoints on the role of corporations in society and their implications for corporate governance. A simplistic approach that focuses on one particular social perspective to the exclusion of others is unlikely to do justice to the complexity of corporate decision-making or the overall contributions of corporations to society. A balanced approach, under which companies are judged according to their overall economic and other contributions and impacts, including how they manage social and environmental issues relevant to their business, is more productive and meaningful.*

The social responsibility of corporations has emerged as a topic of significant popular interest. Given the prominence of corporate enterprises in modern society and the considerable power and influence of particular companies, this interest is not surprising. The ways in which companies conduct themselves and the extent to which they are perceived to be taking responsibility for the consequences of their actions can be expected to attract continuing scrutiny, particularly where those activities touch on environmental or other issues of community concern.

Governments can and do influence corporate behaviour through legislative and other regulatory initiatives. There are limits, however, to the extent to which legislation can prescribe what will amount to responsible corporate decisions, just as there are limits in prescribing good behaviour by other bodies or individuals. Within the confines of the law and the context of varying interests and views within which they operate, companies have to chart their own course, just as individuals do.

What responsibility calls for in particular situations will not always be clear. It generally calls for judgment, a balancing of interests and considerations, not just a reflection of one particular viewpoint. However, companies and those who govern their affairs do not operate in a values-free zone and their activities are and should be subject to evaluation and criticism. Within the marketplace of opinions, preferences and communication, the views and expectations of investors, employees, customers, local communities and other interest groups influence the way in which companies conduct their businesses and present themselves.

The responsibility of companies in carrying out their business should be judged in the context of the contributions they make through the goods and services they provide, their return to shareholders, the taxes they pay, the provision of jobs for employees and so on, as well as other sometimes broader impacts of their activities. While tensions may arise in particular circumstances, any notion that private profit and public interest are incompatible is misconceived and unhelpful.

On a rounded view, social responsibility, like effective corporate governance, can be seen as part and parcel of the way a company's affairs are conducted. It is not an 'add-on', something to be addressed incidentally to the core of the business in order to satisfy particular third party concerns. Those in charge of a company's affairs should have an interest in managing external impacts of the business in relation to the environment, human rights and other matters that may impinge on the success of the business. To go further and expect a company to place greater emphasis on a particular issue that some groups may consider important for the community overall, but that is not germane to the company's business, may only distract attention from its business purpose for no real gain.

On this rounded approach, a company will be seen to be socially responsible if it operates in an open and accountable manner, uses its resources for productive ends, complies with relevant regulatory requirements and acknowledges and takes responsibility for the consequences of its actions. For some companies, this will require them to engage with particular social and environmental issues.

# 1 Overview

*This chapter refers to current interest in the social responsibility of corporations, describes the review process, provides information about the Advisory Committee and indicates the broad outcome of the Advisory Committee's review.*

## 1.1 Current interest

There is a wave of interest in issues relating to the social responsibility of corporations, including calls by community groups and others for companies to give greater attention to the environmental, social and economic impacts of their activities and to report more fully on their performance in this regard.

The current interest reflects in part the success of the corporation as a vehicle for productive enterprise and the visibility of corporate business activities. The degree of responsibility displayed by particular companies in the course of their business affairs is understandably a matter of public interest.

The success of the corporate entity as a vehicle for harnessing capital and human, physical and intellectual resources to productive ends has resulted in the corporation becoming the predominant form of private sector business organization and one that is frequently adopted for non-profit and state-owned bodies as well. The corporate structure has:

permitted people to raise capital from the public, to invest it without, in most cases, a danger of personal risk and to engage in entrepreneurial activity which, otherwise, would probably not occur.<sup>1</sup>

Companies large and small are involved in providing all manner of goods, services and related activities locally and sometimes globally.

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<sup>1</sup> **Source.** The Hon. Justice Michael Kirby, *The Company Director: Past, Present and Future*, address to the Australian Institute of Company Directors, Hobart, 31 March 1998.

The prominent role of companies in the provision of goods and services, and the perceived reach of corporate activities and influence, have also given rise to concerns about the impact of corporate conduct on broader community interests (including, for example, through environmental effects) and the transparency and accountability of the way in which companies conduct their affairs. Questions have been raised about whether corporations have a responsibility to society going beyond their role as participants in the economic system. There may be underlying concerns too about 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.

Current interest in these matters within Australia and elsewhere 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.

Within this broad context, the Advisory Committee was 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.

## 1.2 The review process

### 1.2.1 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?

### 1.2.2 Discussion paper

The Advisory Committee discussion paper *Corporate social responsibility* (November 2005) reviewed 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 was made to discussion and developments at the international as well as local level.

The discussion paper pointed out that 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. The discussion paper reflected the Advisory Committee's own research and preliminary consideration. It sought to provide information, draw out issues and stimulate discussion, as part of a process of public consultation.

### 1.2.3 Submissions

The Advisory Committee received a large number of submissions in response to the discussion paper. The respondents are listed in the Appendix. Summaries of their submissions are set out in each of the relevant chapters. More detailed versions of those summaries, as well as the complete submissions, are available at [www.camac.gov.au](http://www.camac.gov.au)

The Advisory Committee was greatly assisted in its consideration of the issues by the information and views provided in these responses.

The Committee expresses its appreciation to all respondents for their contributions.

### 1.3 Parallel inquiry

Following a separate inquiry, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in June 2006 published a report *Corporate responsibility: managing risk and creating value*. Briefly stated, the recommendations in that report included:

- no change to the provisions concerning directors' duties
- social responsibility/sustainability type reporting to remain voluntary
- various initiatives by government to encourage socially responsible corporate practices, including education, the seeding of a national network, and research.

Where relevant, reference is made for the convenience of readers to recommendations in the PJC report.

### 1.4 Outline of the report

This report includes information and analysis for those with an interest in the subject, as well as responding to the questions raised in the terms of reference. Chapter 2 provides background and outlines developments relevant to understanding various facets of the debate about the social responsibility of corporations and the implications for corporate practice. Chapters 3 to 5 deal with the specific topics on which the Advisory Committee has been asked to provide advice.

#### Understanding the issues

The focus of the discussion on what is commonly referred to as corporate social responsibility is the extent to which companies do, or should, take into account the environmental and social impact of their activities.

This topic has multiple dimensions, many of which are being considered around the world, and which are subject to debate and development. As pointed out on *The Prime Minister's Community Business Partnership* website:

There is an enormous wealth of information worldwide about corporate social responsibility [CSR]: including from web sites; discussion forums; specialist magazines and periodicals; published papers; news media, including the financial press; government publications; business and community organisations; awards programs; newsletters; private consultants; educational institutions; research bodies and company reports. Every month, conferences, seminars and workshops with a CSR theme take place somewhere in the world.<sup>2</sup>

This report seeks to assist companies and others to understand the dimensions of this topic and its possible implications for them. It includes extensive references to Australian and overseas research and other available information. The report draws on, as well as adds to, information and analysis in the discussion paper, and replaces that paper.

### *Corporations and other entities*

The international debate about corporate social responsibility has largely centred on the conduct of multinational and other large private sector companies. This report likewise addresses the conduct of business corporations. However, the Committee notes that issues of social responsibility also arise for other entities, including smaller proprietary companies, public sector bodies, non-profit organizations, partnerships, trusts and sole traders, where their conduct and activities have environmental or other societal impacts. While the activities of large private sector companies may be more visible, issues of social responsibility are not necessarily confined to them.

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<sup>2</sup> **Useful websites.** The quotation is from [www.partnerships.gov.au](http://www.partnerships.gov.au) which provides continuing information on various corporate social responsibility topics, as well as links to relevant local and overseas websites.

One of many overseas websites with up-to-date information on relevant publications, and links to related websites, is [www.eldis.org](http://www.eldis.org)

Another website that gathers together many press releases from North America and elsewhere is [www.csrwire.com](http://www.csrwire.com)

## Response to particular questions

The Advisory Committee starts from the position that companies are obliged to comply with applicable laws, including legislation designed to promote or protect various environmental or social values. Beyond that, companies are influenced in their decision-making by the marketplace of opinions and expectations in which their businesses are carried out. They are subject to various pressures that need to be taken into account if a company is to be successful. These include environmental or other social issues that affect a company's business and that, if not adequately addressed, will put the value and viability of the business at risk. Well-managed companies have an incentive to act responsibly in relation to the environmental or social as well as other aspects of their business operations. At the end of the day, however, if market failure is judged to occur in a particular area, governments are able to intervene with legislation tailored to the problem.

These matters are further discussed in Chapter 2, with the Advisory Committee position on the 'business case' for responsible corporate conduct set out in Section 2.5.

### *Duties of directors*

The Advisory Committee was asked:

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?

The Committee does not support revision of the Corporations Act in the manner referred to in these questions. The established formulation of directors' duties allows directors sufficient flexibility to take relevant interests and broader community considerations into account. Changes of a kind proposed from time to time do not provide meaningful clarification for directors, yet risk obscuring their accountability.

The Committee considers that the most effective response to concerns that may arise from time to time about the environmental and social impact of business behaviour, and where the market is judged unable satisfactorily to respond, is through specific legislation directed to the problem area. Laws of this kind can produce a consistent approach to particular environmental or social issues by being made applicable to all relevant enterprises, public as well as private, including companies, partnerships, trusts, unincorporated entities, sole traders and other individuals. The Corporations Act does not have this width of coverage.

These matters are further discussed in Chapter 3, with the Committee's views developed in Section 3.12.

### *Corporate disclosure*

The Advisory Committee was asked:

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

The Committee recognises the importance of disclosure as a means of encouraging responsible conduct. The form and nature of reporting on relevant matters, including environmental and social aspects, are in a state of evolution, with some companies showing the way, including by following various voluntary disclosure guidelines.

The Committee considers that s 299A of the Corporations Act already provides a general framework for the disclosure of relevant non-financial information. It is an appropriate basis for reporting about environmental and social issues relevant to a company's business. The Committee considers that the reporting obligations in s 299A should be extended beyond listed public companies to all listed entities. Beyond that, the Committee does not see a need at this stage for the Corporations Act to go further in requiring companies or certain classes of companies to report on the social or environmental aspects of their activities.

In relation to listed companies, the ASX through its Listing Rules and Corporate Governance Council principles and disclosure guidelines is also able to assist in responding to changing market expectations with a greater degree of flexibility than legislation.

These matters are further discussed in Chapter 4, with the Committee's views developed in Section 4.10.

### *Encouraging responsible business practices*

The Advisory Committee was asked:

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

The principal role for government, as the Committee sees it, is in providing the public policy settings within which companies operate. Governments provide boundaries for corporate behaviour through legislation. Governmental efforts to maintain and strengthen the accountability framework for companies are of fundamental importance. Regulatory agencies have a role too, including in promoting compliance and enforcing relevant laws.

Beyond that, the Committee refers to various 'light touch' means by which the Government can facilitate or encourage companies in recognising the benefits of appropriate engagement with the environmental and social context in which they operate:

- *policy coherence and integration:* taking a 'whole-of-government' approach, as well as a 'national' approach, in regard to policies and administrative arrangements, at whatever level of government, that have implications for responsible corporate behaviour
- *leadership by example:* setting an example to the private sector through public agency governance and disclosure standards
- *promotion:* looking for ways to assist or encourage companies, investors and other interested parties to engage with relevant issues such as by disseminating information and, where appropriate, commissioning research and other material
- *encouraging participation:* consulting with the corporate sector on inter-governmental developments on international codes or guidelines and encouraging corporate participation in relevant non-government initiatives.

These matters are further discussed in Chapter 5, with the Committee's views developed in Section 5.9.

## 1.5 The Advisory Committee

The Advisory Committee was established in 1989 to provide a source of independent advice to the responsible minister (the Treasurer) on any aspect of corporate or financial markets law reform or any proposal to improve the efficiency of the financial markets. It is constituted under Part 9 of the *Australian Securities and Investments Commission Act 2001*.

The members of the Committee are selected by the Minister, following consultation with the States and Territories. They are appointed in a personal, not a representative, capacity, and must have relevant personal or professional experience.

The members during the course of preparing this report were:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne
- Zelinda Bafile—Company Director and former General Counsel and Company Secretary, Home Building Society Ltd, Perth
- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Louise McBride—Barrister, 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
- the Chairman of the Australian Securities and Investments Commission or his nominee.

The Advisory Committee is assisted in its work by a Legal Committee, which provides expert legal analysis, assessment and

advice on matters referred to it by the Advisory Committee. The members 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 during the course of preparing this report were:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Julie Abramson—General Manager, National Australia Bank, Melbourne
- 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
- Laurie Shervington—Partner, Minter Ellison, Perth
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gary Watts—Partner, Fisher Jeffries, Adelaide.

The Advisory Committee is supported by an Executive, the members of which during the course of this inquiry were:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Liam Burgess—Policy Consultant
- Thamani (Timmi) Parrino—Office Manager.

The Executive obtained assistance from Liz Lange of the Sustainability Consulting Group in the course of this review.



## 2 The international context

*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.*

### 2.1 The concept

The concept of corporate social responsibility (or comparable notions such as ‘corporate citizenship’, ‘corporate social accountability’ or ‘corporate responsibility’), while not a new idea, has become a significant theme in the business and wider community.<sup>3</sup>

The term ‘corporate social responsibility’ does not have a precise or fixed meaning. Some descriptions focus on corporate compliance with the spirit as well as the letter of applicable laws regulating corporate conduct. Other definitions refer to a business approach by which an enterprise takes into account the impacts of its activities on interest groups (often referred to as stakeholders) including, but extending beyond, shareholders, and balances longer-term societal

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<sup>3</sup> **Increasing recognition.** The Economist Intelligence Unit *The importance of corporate social responsibility* (2005) at 5 indicated that, 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%. The Economist Intelligence Unit report also observed that:

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 (at 3).

impacts against shorter-term financial gains.<sup>4</sup> These societal effects, going beyond the goods or services provided by companies and their returns to shareholders, are typically subdivided into environmental, social and economic impacts.<sup>5</sup> The term ‘social impact’ is generally used in this report to include economic matters referred to in some descriptions.

The social responsibility of corporations needs to be considered against the background of the broader corporate governance debate concerning the relationship between the board, management and

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This pattern has continued. The report by The Conference Board, *Reward trumps Risk: How Business perspectives on Corporate Citizenship and Sustainability are changing* (November 2006) stated that two thirds of the 198 medium to large multinational companies surveyed said that corporate social responsibility/sustainability issues were of growing importance to their businesses, while 90% of the companies surveyed saw these issues as sources of commercial opportunity and/or risk for them.

<sup>4</sup> **Definitions.** 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’.

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 World Business Council for Sustainable Development in *Corporate Social responsibility: the WBCSD’s journey* describes it as ‘the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life’.

The International Organization for Standardization (ISO) *Working Group on ISO 26000 Guidance on Social Responsibility* refers to: ‘the actions of an organisation to take responsibility for the impacts of its activities on society and the environment, where these actions: (a) are consistent with the interests of society and sustainable development; (b) are based on ethical behaviour, compliance with applicable law and international instruments; and (c) are integrated into the ongoing activities of the organisation’.

Other definitions are included on *The Prime Minister’s Community Business Partnership* website [www.partnerships.gov.au](http://www.partnerships.gov.au)

<sup>5</sup> **Environmental, social and economic impacts.** 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
- *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.

Similar concepts are found in the GRI Sustainability Reporting Guidelines G3 (2006).

shareholders, the impact of various corporate scandals both in Australia and elsewhere on that debate, and changes in the governance framework in recent years. The thrust of most legislative efforts has been to strengthen the accountability of directors and other managers 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, rather than impair, the accountability of corporations and those who conduct their affairs.

Social responsibility issues are a subset of the wider theme of corporate governance. However, this report does not deal with governance issues such as conflicts of interest affecting corporate decision-makers, insider trading, improper use of corporate information or position, or other forms of self-dealing, securities manipulation, fraud or financial deception. While these matters, as reflected from time to time in the circumstances surrounding corporate failures, can affect community perceptions of commercial morality, they have their own legislative and regulatory issues. There is, of course, no guarantee that a company that pursues social responsibility goals will otherwise be well-governed.<sup>6</sup>

In essence, the focus of the issue of corporate social responsibility is on the way in which the affairs of companies are conducted and the ends to which their activities are directed, with particular reference to the environmental and social impact of their conduct. A responsible company, like a responsible individual, is one that acknowledges and takes responsibility for its actions.

## 2.2 History

Consideration of the social responsibility of corporations, and continuing debate about the implications for corporate conduct and regulation, first emerged in the USA and have since been taken up

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<sup>6</sup> **Experience from Enron.** D Vogel in *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution, 2005) observed (at 38) that, while the Enron saga involved serious breaches by particular individuals of their governance obligations, Enron was widely respected for its corporate social responsibility performance, including its environmental record, triple bottom line reporting, codes of conduct regarding human rights and philanthropic contributions.

through United Nations (UN) and other international initiatives and in the European Union (EU) and elsewhere.

Much of the debate has centred on the interaction of the 'shareholder primacy' approach to corporate decision-making (sometimes described in terms of 'maximising shareholder wealth') and the social and environmental impact of corporate conduct.

Globalisation has become a significant factor in the debate. One aspect has been the expanding role and perceived influence of major corporations, often operating across many jurisdictions and sometimes becoming involved, following privatisation processes and public/private partnerships, in activities previously seen as the preserve of government. Another aspect has been the growth of not-for-profit or non-government organizations (NGOs) that may themselves operate internationally and monitor and seek to influence corporate business in accordance with or to further various societal goals.<sup>7</sup>

The interaction of these developments has created pressures for corporate management. As summed up by one commentator:

Over the past twenty years managers of publicly quoted companies, especially large ones, have been under pressure on two fronts. On one side they are urged by increasingly active and interventionist investors to devote themselves single-mindedly to maximising shareholder value; if they do not, they are liable to be replaced by managers who are more attentive to shareholders' needs. This view is propagated most strongly by American investors, and is based on the belief that the American version of capitalism, with its highly developed capital markets and frequent recourse to hostile take-overs, is better than any other model at generating economic growth ... On the other side managers are facing calls from a variety of external groups ... to conduct their affairs in a more socially responsible way ... generally taken to involve a concern for the environment, for human rights, and for the health of the societies in which companies operate ... Some CSR activists believe that companies should give social and environmental

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<sup>7</sup> **Role of NGOs.** The *Accountability Charter* (June 2006), developed by various international human rights, environmental and social development NGOs, sets out principles for responsible advocacy by these bodies.

considerations at least as much weight in their decision-making as shareholder value.<sup>8</sup>

NGOs and other interested parties have also been able to utilise global communication developments in tracking and publicising the performance of particular companies against environmental and social standards.<sup>9</sup> Again, as summed up by the commentator:

The [corporate social responsibility] movement ... reflects, at least in part, a genuine change in the environment in which business operates. There is a widespread demand for greater openness on the part of companies, and an entirely legitimate interest in the wider social impact of what they do. Managers of large companies increasingly have to operate on the assumption that virtually everything they do, however secret, will one day be exposed to public view; the impact of such revelations on their reputation, in the eyes of employees as well as customers, has to be taken very seriously.<sup>10</sup>

A further aspect of globalisation concerns debate on the extent to which international codes and other initiatives that have a bearing on responsible corporate conduct should be supported by some form of legal obligation or redress. Most international corporate conduct or reporting norms or standards in this area are voluntary and rely on individual companies agreeing to adopt and apply them. On the other hand, various international anti-corruption conventions have been adopted by countries in their anti-corruption legislation, often with extraterritorial effect.<sup>11</sup> More controversial has been the attempt

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<sup>8</sup> **Source.** G Owen, *Companies, managers and society; the state of the debate*, Introductory paper for the Conference on Corporate Social Responsibility organised by the 21<sup>st</sup> Century Fund, Cambridge, England, October 2005.

<sup>9</sup> **Impact of communication technology.** A report by Fleishman-Hillard and the National Consumers League, *Rethinking corporate social responsibility* (2006), stated that one of the key findings from a nationwide survey of consumers in the USA in 2006 was that 'technology is changing the landscape in which consumers gather and communicate information about how well companies are being socially responsible' and that 'the proliferation of the Internet has created a more informed, more empowered consumer'.

<sup>10</sup> **Source.** G Owen, *Companies, managers and society; the state of the debate*, Introductory paper for the Conference on Corporate Social Responsibility organised by the 21<sup>st</sup> Century Fund, Cambridge, England, October 2005.

<sup>11</sup> **Anti-corruption.** The Commonwealth *Criminal Code* Division 70 (Bribery of foreign public officials) gives effect to the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (1997). Also relevant is the *UN Convention against Corruption* (2003), which deals with prevention, criminalisation, international cooperation and asset recovery.

through an international forum to introduce some form of legal obligation directly on companies concerning the labour and other human rights aspects of their activities.<sup>12</sup>

## 2.2.1 USA

Much of the debate about the social responsibility of corporations has focused on the merits of what has been described as the

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Compare the US *Foreign Corrupt Practices Act* of 1977, which prohibits the giving of bribes to foreign persons by US incorporated companies, US individuals, foreign companies listed on US stock exchanges and their employees and agents.

A review of global trends in the enforcement of the OECD convention, including an analysis of the adequacy of the legal framework for foreign bribery prosecutions in various countries, is provided by Transparency International *2006 TI Progress Report: Enforcement of the OECD Convention on Combating Bribery of Foreign Public Officials* (June 2006). Transparency International also publishes an annual *Global Corruption Report*, which analyses the level, and impact, of bribery and corruption in various countries. In addition, the Transparency International *2006 Bribe Payers Index* looks at the level of propensity of companies from 30 leading exporting countries to pay bribes in their overseas operations.

<sup>12</sup> **Controversy.** The *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003) have been contentious since their adoption by a UN sub-commission in August 2003. One of the most contentious aspects has been the apparent attempt in the draft norms to provide legal remedies for breaches by corporations of the human rights principles in them, which in turn has been a principal reason that the draft norms have not been formally adopted by the UN.

D Kinley, J Nolan & N Zerial, in 'The Norms are dead! Long live the Norms!' *Company and Securities Law Journal* (forthcoming), outline the nature of the debate on this issue.

The draft norms are currently being reviewed by Professor John Ruggie of the Kennedy School of Government, Harvard University. He was appointed in July 2005 to undertake that task as the UN Secretary-General's Special Representative on Business and Human Rights. He issued an *Interim Report* in February 2006, and his final report is due in 2007.

A useful source of information on the ongoing work of the Special Representative is provided by the Business and Human Rights Resource Centre.

The Business Leaders Initiative on Human Rights *Report 3: Towards a 'Common Framework' on Business and Human Rights: Identifying Components* (June 2006) sought to 'road test' the content of the draft norms and develop a 'common framework' to assist businesses in implementing relevant human rights policies and practices into their operations.

One of the issues in any attempt to impose obligations on companies under the draft norms is to determine the concept of corporate 'complicity' in human rights abuses. Various studies, including University of Virginia School of Law and EarthRights International *The international law standard for corporate aiding and abetting liability* (2006) and A Ramasastry & R Thompson, *Commerce, Crime and Conflict: Legal Remedies for Private Sector Liability for Grave Breaches of International Law* (Institute of Applied Social Science (Fafo), Norway, September 2006), seek to identify the general legal principles governing complicity of corporations operating internationally in human rights abuses.

'shareholder primacy' or 'shareholder supremacy' approach to corporate decision-making, in particular whether the role of the company is to maximize shareholder wealth, and, if so, what implications that has for the broader community.<sup>13</sup>

An early leading case on 'shareholder primacy' 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 its 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 Adolf 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 they are the investors who have put their capital at risk, and that the directors should be answerable only to them. Any attempt to broaden these responsibilities to persons other than shareholders may result in directors having no legally enforceable responsibilities to anyone.<sup>14</sup>

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<sup>13</sup> **History.** For a useful overview of the history of the corporate social responsibility concept in the United States, see CA Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century' (2002) 51 *Kansas Law Review* 77.

<sup>14</sup> **Shareholder primacy.** 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. In the latter article, Professor Berle argued (at 1367) that:

In reply, Professor Merrick 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.<sup>15</sup> An argument in support 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 and therefore had social obligations to affected groups beyond shareholders.<sup>16</sup>

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.<sup>17</sup> Concerns also began to be raised about what was described as ‘short-termism’, whereby some corporate managers, in response to shareholder and market pressure and sometimes to improve their own position, appeared to focus on achieving short-term profitability, even at the expense of longer-term

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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.

<sup>15</sup> **Broader duties.** EM Dodd, ‘For Whom are Corporate Managers Trustees?’ (1932) 45 *Harvard Law Review* 1145 at 1162.

<sup>16</sup> **Power and influence of corporations.** Well-known authors from the period who analysed the power of corporations included 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).

<sup>17</sup> **Environmental and social issues.** Consumer activism was encouraged by Ralph Nader, *Unsafe at any Speed* (1965). Also, A Berle & G Means, *The Modern Corporation and Private Property* (1967) analysed the social and environmental impact of larger US corporations.

considerations, including the environmental and social context in which the corporation operated.<sup>18</sup>

During that period, proponents of the view that corporations have broader social responsibilities began to make use of shareholder proposal laws in attempts to influence corporate policy or conduct.<sup>19</sup> 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 and the proper functions of private enterprise.<sup>20</sup>

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<sup>18</sup> **Short-termism.** This has remained a continuing issue in the USA and elsewhere. The US Business Roundtable Institute for Corporate Ethics report *Breaking the Short-term Cycle* (July 2006) proposed various measures to overcome what the report described as 'the excessive focus of some corporate leaders, investors and analysts on short-term quarterly earnings and lack of attention to the strategy, fundamentals and conventional approaches to long term value creation'.

<sup>19</sup> **Shareholder proposals.** 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 social and other proposals for consideration.

Use of this SEC rule 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.

According to the Investor Network on Climate Risk, during the 2006 US proxy season, 'more than two-dozen climate related shareholder resolutions were filed with [US] companies, many of which were ultimately withdrawn by shareholders after a satisfactory pledge by the company to implement the request'.

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'.

<sup>20</sup> **Views of Milton Friedman.** Milton 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 is to use its resources and engage in activities designed to increase its profits and the only restriction in so doing is 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. For directors to use corporate resources for broader environmental or social purposes is tantamount to mismanagement of shareholder funds.

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 takeovers. The requirement on a board of directors to act in the best interests of the corporation was seen by some, in the context of a takeover bid, as precluding target boards from giving sufficient weight in their assessment of the bid to detrimental social effects, such as retrenchment of employees, closing or relocating of factories or other rationalisations that might adversely affect local communities.<sup>21</sup>

In response, a majority of US states 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.<sup>22</sup>

One theme in 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

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<sup>21</sup> **Relevant case law.** 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.

<sup>22</sup> **Corporate constituency statutes.** 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.

A useful analysis of the corporate constituency statutes is found in E Orts, 'Beyond shareholders: interpreting corporate constituency statutes' (1992) 61.1 *George Washington Law Review* 14.

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.<sup>23</sup>

Another theme is renewed debate on the ‘shareholder primacy’ approach to corporate decision-making. One view, often referred to as the ‘principal-agent’ model of the corporation, is that directors and other corporate managers are agents for the shareholders and, in that role, are accountable only to shareholders and must manage their companies to maximise shareholder wealth, at least over time.<sup>24</sup> In this context it has been argued that shareholders should be given stronger participatory rights and corporate power to protect their interests.<sup>25</sup>

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<sup>23</sup> **Non-financial disclosure.** 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.

The Investor Network on Climate Risk (representing US institutional investors managing more than US\$1 trillion in assets) in June 2006 called on the US Securities and Exchange Commission to require companies to disclose in their securities filings their risks from global warming.

<sup>24</sup> **Directors as agents of shareholders.** For instance, H Hansmann and R Kraakman in ‘The end of history for corporate law’ (2001) 89 *Georgetown Law Journal* 439 at 441 argue that in relation to international trends in the law of corporate governance:

there is today a broad normative consensus that shareholders alone are the parties to whom corporate managers should be accountable.

The authors elsewhere, in Kraakman and others *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2004), point out (at 18) that this does not mean that the interests of non-shareholder groups should, or can, be disregarded by directors and other corporate managers:

In general, creditors, workers, and customers will consent to deal with a corporation only if they expect to be better off themselves as a result. Consequently, the corporation—and, in particular, its shareholders—has a direct pecuniary interest in making sure that corporate transactions are beneficial, not just to the shareholders, but to all parties who deal with the firm.

<sup>25</sup> **Increased power for shareholders.** L Bebchuk, in ‘The case for increasing shareholder power’ (2005) 118 *Harvard Law Review* 833 and ‘Letting shareholders set the rules’ (2006) 119 *Harvard Law Review* 1784, argues that corporate governance of US public companies could be improved by eliminating or reducing some of the current legally imposed limits on shareholder power and allowing shareholders to make more ‘rules-of-the-game’ decisions. A critique is provided by Justice L Strine ‘Towards a true corporate republic: A traditionalist response to Bebchuk’s solution for improving corporate America’ (2006) 119 *Harvard Law Review* 1759.

A contrary view is that shareholders are not an homogeneous group and some of them may use any enhanced shareholder powers in a self-serving manner that does not benefit shareholders generally: I Anabtawi, ‘Some scepticism about increasing shareholder power’ (2006) 53 *UCLA Law Review* 561.

A differing view to shareholder primacy envisages the board of directors acting to promote the interests of all stakeholders.<sup>26</sup> One approach describes the role of directors as a ‘mediating hierarchy’, 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 corporate ‘team’ can include, in addition to shareholders, all those groups that contribute in some manner to a company’s wealth production.<sup>27</sup> The directors should have considerable discretion in allocating benefits between these team members to keep the team together and keep it productive, ‘even if it works against the interests of particular shareholders in particular firms at particular times’.<sup>28</sup>

### 2.2.2 International

Beginning in the 1970s, and increasingly in the last decade, international bodies such as the UN and the Organisation for Economic Co-operation and Development (OECD) have developed guidelines and other policy documents as models of appropriate corporate behaviour, particularly for multinational or other large corporations.

<sup>26</sup> **Critique of shareholder primacy approach.** K Greenfield in *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (University of Chicago Press 2006) argues that corporations can be managed to promote the interests of all stakeholders, including shareholders, employees, creditors and the communities in which corporations operate, while promoting both profits and social welfare.

<sup>27</sup> **Team production theory of the corporation.** 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. According to Blair and Stout in their article ‘Specific investment and corporate law’ in *European Business Organization Law Review* (forthcoming):

The appropriate normative goal for a board of directors is to build and protect the wealth-creating potential of the entire corporate team—‘wealth’ that is reflected not only in dividends and share appreciation for shareholders, but also in reduced risk for creditors, better health benefits for employees, promotional opportunities and perks for executives, better product support for customers, and good ‘corporate citizenship’ in the community.

<sup>28</sup> **Discretion to directors.** M Blair and L Stout in ‘Specific investment and corporate law’ in *European Business Organization Law Review* (forthcoming) argue that: director discretion, including the discretion that comes from open-ended rules of corporate purpose, serves the long-run interests of ‘the investor class’ even if it works against the interests of particular shareholders in particular firms at particular times.

S Bainbridge in ‘Director primacy and shareholder disempowerment’ (2006) 119 *Harvard Law Review* 1735 supports the view put forward by Blair and Stout that directors should have increased discretion to carry out their managerial functions.

There is now an array of international codes, norms, principles, guidelines, standards and indices dealing with responsible corporate conduct.<sup>29</sup> This section summarises some of the key documents and indices.

### *Standards and guidelines*

Various voluntary standards provide guidance to corporations and financial intermediaries on aspects of socially responsible corporate conduct. They are designed to set benchmarks for appropriate corporate conduct, which, in countries where the rule of law is weak, may well be significantly higher than what is required by local laws or practices. The principal ones are:

- *OECD Guidelines for Multinational Enterprises* (2000), that set out voluntary guidelines for responsible business conduct by multinational enterprises operating in or from OECD member countries, including Australia.<sup>30</sup> 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'.<sup>31</sup> They cover major areas of business conduct, including employment and industrial relations, human

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<sup>29</sup> **Collations of codes and guidelines.** K McKague & W Cragg, *Compendium of Ethics Codes and Instruments of Corporate Responsibility* (September 2005) contains a comprehensive collection, as at that date, of relevant codes, guidelines and other instruments of corporate responsibility in global markets.

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.

L Paine, R Deshpandé, J Margolis & K Bettcher, 'Up to Code: Does your company's conduct meet world-class standards?' *Harvard Business Review* December 2005 at 122–133 seeks to integrate the range of global codes of conduct for corporate behaviour, including matters coming within the concept of socially responsible corporate conduct.

<sup>30</sup> **Australian contact.** The Australian National Contact Point for the OECD Guidelines is the Executive Member of the Foreign Investment Review Board.

<sup>31</sup> **Source.** *OECD Guidelines for Multinational Enterprises* (2000), p 17, para 10.

rights, environmental protection, combating bribery, consumer interests and competition<sup>32</sup>

- UN *Global Compact* (2000), under which companies may voluntarily commit themselves to 10 principles to guide their conduct in the areas of human rights, labour standards and practices, the environment and anti-corruption.<sup>33</sup> In addition, the *Global Compact Cities Programme* (2003) seeks to improve the quality of urban life through local voluntary cross-sector partnerships between business, government and civil society to deal with environmental, social or economic urban problems<sup>34</sup>
- 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

<sup>32</sup> **Explaining the OECD Guidelines.** Various aspects of the OECD Guidelines are explained in OECD Watch, *The OECD Guidelines for Multinational Enterprises: The Confidentiality Principle, Transparency and the Specific Instance Procedure* (2006). The complaints procedure under the Guidelines is explained and analysed in OECD Watch *Guide to the OECD Guidelines for Multinational Enterprises Complaint Procedure: Lessons from Past NGO Complaints* (June 2006) and *Promotion of the Guidelines and the Role of National Contact Points in Handling Specific Instances* (June 2006).

<sup>33</sup> **UN Global Compact principles.** The current 10 principles 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 UN Convention against Corruption (2003). A useful summary is found in the World Business Council for Sustainable Development, *The UN Global Compact: a primer on the principles* (2004). The Global Compact has over 3000 participating companies from more than 100 countries.

The Global Compact continues to publish a range of documents on implementing its principles, including:

- *On corporate responsibility for human rights* (April 2006), in which the Special Advisor to the Secretary-General on the Global Compact sets out the 'business case' for corporate human rights engagement, particularly in jurisdictions with deficient human rights laws
- *Business against corruption: a framework for action* (December 2005), which analyses a range of reasons why it is in a company's own business interests to ensure that it does not engage in corrupt practices, and also identifies practical steps to fight corruption.

Global Compact has also produced the 'OneReport COP Publisher', designed to guide companies to produce web-based 'Communication of Progress' (COP) reports on how they integrate the 10 principles into their day-to-day business operations and practices.

<sup>34</sup> **Global Compact Cities Programme.** The Global Compact has initiated a Pilot Project Phase from 2006 to 2009, utilising the 'Melbourne model' of cross-sector partnerships.

- *Draft 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 applicable to transnational corporations and other businesses. The Draft Norms consolidate a range of human rights principles found in UN and other multilateral instruments and voluntary codes, with voluntary business performance standards in relation to them. The Draft Norms are still the subject of debate.<sup>35</sup>
- *UN Environment Program Finance Initiative* (1992, restructured in 2003), a voluntary partnership between the UN and the financial sector, comprising bankers, insurers and fund managers working to identify, promote and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations
- *UN Principles for Responsible Investment* (2006), under which pension funds and other institutional investors who are signatories undertake that they will take into account in their investment decisions whether companies meet certain environmental, social and ethical standards.

Some international conventions have also been adopted into law. For instance, the Commonwealth *Criminal Code* Division 70 (Bribery of foreign public officials) gives effect to the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (1997).

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<sup>35</sup> **Draft UN Norms.** These draft norms, which include employee, consumer protection and environmental standards, are based on the view, as expressed in the 2003 draft 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.

A useful analysis of these draft norms is by T Rathgeber *UN Norms on the Responsibilities of Transnational Corporations* (Friedrich Ebert Stiftung, April 2006).

The report by SustainAbility *Reporting on Human Rights 2005* discusses how companies can report on their human rights initiatives, taking into account the expectations of stakeholders. See also Business Leaders Initiative on Human Rights *Report 3: Towards a 'Common Framework' on Business and Human Rights: Identifying Components* (2006).

The debate concerning the future of the draft norms is discussed at footnote 12.

### *Management systems and certification schemes*

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

- *International Organization for Standardization (ISO) 14000 series*, dealing with environmental management<sup>36</sup>
- *Social Accountability 8000 (SA8000)*, relevant to labour standards in developing countries<sup>37</sup>
- *AccountAbility 1000 (AA1000) Series*, which includes guidance to 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, an International Standard on Social Responsibility, due for release in 2009.

### *Accountability and reporting frameworks*

There is a diversity of methods available to organizations that choose to report on the social and environmental aspects of their activities.<sup>38</sup>

The Global Reporting Initiative (GRI) Sustainability Reporting Guidelines provide a voluntary reporting standard that has been gaining acceptance.<sup>39</sup>

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<sup>36</sup> **ISO.** The International Organization for Standardization is a non-government body whose role is to facilitate a network for national standards institutes in over 150 countries, including Standards Australia.

<sup>37</sup> **SA8000.** This standard is based on the core conventions of the International Labour Organization. The New York based Social Accountability International arranges for third party auditors to certify whether a company conforms with the SA8000 standards.

<sup>38</sup> **Summary of methods.** A very useful overview of the principal non-financial reporting initiatives in Europe, the United States and the Asia-Pacific region is found in the publication by the Institute of Chartered Accountants in Australia, *Extended performance reporting: An overview of techniques* (January 2006).

The GRI guidelines are supported by other standards dealing with the independent verification of sustainability-type reports, such as:

- *AA1000 Assurance Standard*<sup>40</sup>
- *International Standard on Assurance Engagements (ISAE 3000)*, issued by the International Auditing and Assurance Standards Board.<sup>41</sup>

The OECD *Guidelines for Multinational Enterprises* encourage regular, reliable and relevant disclosures of non-financial as well as financial performance, while the *UN Global Compact* expects participants to submit annual ‘Communications on Progress’ using reporting indicators such as the GRI. Also, the *Carbon Disclosure Project* and the *Global Framework for Climate Risk Disclosure* deal with voluntary reporting of matters related to climate change.<sup>42</sup> There are various other voluntary reporting standards.<sup>43</sup>

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<sup>39</sup> **The GRI organization.** 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).

<sup>40</sup> **The AA1000 Series Assurance Standard.** This standard, developed by the UK-based organization AccountAbility, deals with the 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.

The AA1000AS Register, launched in October 2006, provides a complete list of reports assured using the AA1000 Assurance Standard.

<sup>41</sup> **ISAE 3000.** 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.

<sup>42</sup> **Climate change.** The *Global Framework for Climate Risk Disclosure* (October 2006), prepared by a group of international institutional investors, and *Using the Global Framework for Climate Risk Disclosure* (October 2006) are further discussed in footnotes 73 and 109. The Carbon Disclosure Project is discussed in Section 5.2.3.

<sup>43</sup> **Other reporting standards.** These include the *Social Performance Indicators—Finance 2002* (SPI), the *Environmental Performance Indicators—Finance 2000* (EPI) and the *VfU Environmental Indicators 2005*, developed by various global financial service institutions as specialised sets of performance indicators for the finance industry.

### 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<sup>44</sup>
- *FTSE4Good Index Series* (a subset of the FTSE share trading indices), which measures the performance of companies that meet globally recognised corporate responsibility standards.<sup>45</sup>

### Integration

There has been some movement towards assisting corporations to integrate the array of norms, standards and principles into their corporate operations. For instance, companies participating in the Global Compact may use the GRI reporting guidelines to report on their progress in implementing the Global Compact principles.<sup>46</sup> Likewise, the Global Compact and the ISO have entered into an arrangement to collaborate on the development and promotion of the foreshadowed ISO International Standard on Social Responsibility and to ensure its consistency with the Global Compact principles.<sup>47</sup>

### 2.2.3 European Union

The EU 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.

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<sup>44</sup> **Dow Jones Sustainability Index.** This index assesses corporate economic, environmental and social performance, covering issues such as corporate governance, risk management, corporate branding, climate change, supply chain standards and labour practices. Each year the SAM Group reviews what companies should be added to, or deleted from, the Index.

<sup>45</sup> **The FTSE Group.** This is an independent company that originated as a joint venture between the Financial Times and the London Stock Exchange.

<sup>46</sup> **Integration in reporting.** The joint Global Compact and GRI Guide 'Making the Connection: Using GRI's G3 Reporting Guidelines for the UN Global Compact's Communication on Progress' was published in October 2006.

<sup>47</sup> **Source.** UN Global Compact Press release 20 November 2006.

This principle was first adopted in the EU ‘Lisbon Strategy’ (2000) and has been applied in subsequent EU policy documents and other communications.<sup>48</sup> The EU has adopted ongoing processes to foster these corporate social responsibility goals,<sup>49</sup> and has issued a corporate reporting directive involving information about the environmental and other social impacts of corporate activities.<sup>50</sup>

European States have also adopted a range of national policies to promote socially responsible conduct by corporations. France and the United Kingdom have established ministries to promote socially responsible corporate practices.<sup>51</sup> Germany has also taken initiatives concerning sustainable development and the role of German enterprises and interest groups in that process.<sup>52</sup>

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<sup>48</sup> **EU approach.** The EU definition of corporate social responsibility is applied in 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.

A summary of EU initiatives, goals and proposed actions is set out in the European Commission paper, *Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility* (March 2006).

<sup>49</sup> **EU initiatives.** See, for instance, the European Multistakeholder Forum on CSR *Final results & recommendations* (June 2004).

In March 2006, the European Commission launched the *European Alliance for CSR*, a voluntary and informal network for discussion and debate on new and existing corporate social responsibility initiatives by large companies, small and medium enterprises and their stakeholders. Further details are set out in the Annex to the European Commission paper, *Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility* (March 2006).

<sup>50</sup> **EU reporting directive.** *EU Accounts Modernisation Directive* (June 2003).

<sup>51</sup> **UK website.** A UK Government website outlines ongoing UK and EU corporate social responsibility initiatives: [www.csr.gov.uk](http://www.csr.gov.uk)

<sup>52</sup> **German initiatives.** The German Government established the Council for Sustainable Development (Rat für Nachhaltige Entwicklung) to provide ongoing advice on sustainability. Publications by that Council include *Corporate Responsibility in a Globalised World—A German Profile of Corporate Social Responsibility* (September 2006). Further details on the German Council and ongoing developments are at [www.nachhaltigkeitsrat.de](http://www.nachhaltigkeitsrat.de)

## 2.2.4 Australia

Corporate social responsibility has been discussed in Australia over the years.<sup>53</sup> Relevant questions were considered by the Senate Standing Committee on Legal and Constitutional Affairs in its report *Company Directors' Duties* (November 1989). The issues continued to be discussed during the 1990s,<sup>54</sup> at a time when an increasing number of Australia's larger companies began developing policies

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The German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit) publication *Corporate social responsibility: an introduction from the environmental perspective* (March 2006) proposes a more ambitious interpretation of corporate social responsibility among German businesses, including what is involved for companies in designing environmental management systems.

The German Government has also established the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), whose publications include *Sustainable Management for the Future; Findings of a Study on the Implementation of Sustainable Management in German Multinational Companies* (2006).

A German industry body involved in corporate social responsibility issues, and whose website has links to other relevant organisations, is CSR Germany.

<sup>53</sup> **Developments in 1970s and 1980s.** 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.

Compare the initiative in New Zealand in the *State-Owned Enterprises Act 1986*, which provides, in s 4, that the three objectives of each government commercial entity are to operate as profitably and efficiently as comparable private enterprises, be a good employer and also be 'an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so'. This section was considered in *Auckland Electricity Power Board v Electricity Corporation of New Zealand* [1994] 1 NZLR 551 at 558–559. The court considered that the social responsibility objective needed to be read in conjunction with the other two objectives, not as a separate requirement to apply to particular acts or transactions, and that it applied 'when' an enterprise is able to do so, not as far as it is able to do so.

<sup>54</sup> **Developments in 1990s.** 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.

that took into account the impact of their conduct on the broader community.<sup>55</sup>

The social responsibilities of corporations arose in the public discussion of James Hardie Industries Ltd and the ensuing *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (September 2004) (the Jackson report). The report concerned the handling by the parent company of the asbestos liabilities of some of its subsidiaries. One aspect of that report, concerning ‘long-tail liabilities’ (liabilities that arise many years after the events or transactions that give rise to them), is the subject of a separate CAMAC review.<sup>56</sup> The Jackson report also raised the issue whether a holding company should be liable for torts of its subsidiaries that have resulted in personal injury.<sup>57</sup> The Federal and State Ministerial Council is looking further at this issue.

The topic of corporate social responsibility, and its implications for companies, investors and other interest groups, continues to be addressed in public seminars and other forums.

## 2.2.5 Other countries

The social responsibility of corporations is a live topic in many countries and regions. While the emphasis is generally on the environmental and social impact of corporate behaviour, what that

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<sup>55</sup> **Corporate responses since mid-1990s.** H Anderson & I Landau, in ‘Corporate social responsibility in Australia: a review’ *Corporate Law and Accountability Research Group Working Paper No.4* Monash University, October 2006, summarise a range of empirical studies indicating that an increasing number of Australian companies since the mid-1990s have adopted policies consistent with the notion of corporate social responsibility. However, the authors observe that:

the studies conducted to date suggest that the ‘Australian approach’ to CSR is still largely characterised by tentative and short term initiatives of a philanthropic nature. While there are exceptions, most businesses in Australia have not yet sought to integrate the precepts of CSR or corporate citizenship into their strategic approach or corporate culture (at 28).

<sup>56</sup> **Long-tail liabilities.** The Advisory Committee received a reference in October 2005 to review long-tail liabilities. Further details can be found at [www.camac.gov.au](http://www.camac.gov.au)

<sup>57</sup> **Tort liability within corporate groups.** The Advisory Committee outlined the circumstances in which a holding company would be liable for the torts of a subsidiary, and set out arguments for and against extension of those grounds of liability, in Chapter 4 of its report *Corporate Groups* (June 2000) (available at [www.camac.gov.au](http://www.camac.gov.au)).

means in practice, and the types of activities it encompasses, differ in scope or emphasis to reflect local circumstances.<sup>58</sup>

### 2.3 Different approaches

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

- the compliance, philanthropic and business approaches, each being directly or indirectly linked to corporate benefit (which includes avoidance of detriment), and
- the social primacy and social obligation approaches, which are not necessarily linked to corporate benefit.

These approaches are not necessarily mutually exclusive.

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<sup>58</sup> **Differences between countries.** An Ashridge report produced for the Danish Government's Commerce and Companies Agency *Catalogue of CSR Activities: A broad overview* (September 2005) points out that corporate social responsibility activities vary considerably among countries. The report focused on the most common forms of such activities in Europe and North America, including marketplace, workforce, supply chain, community and environmental activities and stakeholder engagement.

Some jurisdictions focus on particular human rights or economic issues, as explained in the report *Corporate social responsibility in Latin America* (Greenleaf Publishing 2006), which emphasises the social role of corporations in South America in improving the living conditions of disadvantaged communities while expanding markets and increasing profitability. These, and other, aspects of relevant issues in Latin America are discussed in the annual *Inter-American Conference on Corporate Social Responsibility*, which began in 2003.

R Welford, 'Corporate Social Responsibility in Europe, North America and Asia' *Journal of Corporate Citizenship* Volume 17, Spring 2005 identifies some cultural differences and differing demands of stakeholders in different geographical regions. A useful source of information on issues and developments in the Asia-Pacific region is *CSR Asia*. An example in one jurisdiction is the *Singapore Compact for CSR*. The Waseda University Institute for Corporation Law and Society has conducted surveys of attitudes to corporate social responsibility in Japan.

Some of the challenges of adopting and applying relevant concepts in China are discussed in a series of articles in *Leading Perspectives CSR in the People's Republic of China* (Summer 2006), published by Business for Social Responsibility. The environmental challenges for companies operating in China are analysed in *CSR Asia Corporate Environmental Reporting and Disclosure in China* (June 2005).

African countries have their own distinctive corporate social responsibility challenges. For instance, the report by the International Centre for Corporate Social Responsibility at Nottingham University Business School *The meaning and practice of CSR in Nigeria* (2006) states that the focus in that country is on corporate philanthropy, aimed principally at addressing socio-economic development challenges, including poverty alleviation and health care provision.

### 2.3.1 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 where they estimate that relevant sanctions are cheaper than the costs of full compliance. Likewise, internal corporate policies should not be used to justify breaches of the law.<sup>59</sup>

The American Law Institute (ALI)<sup>60</sup> *Principles of Corporate Governance* contain model provisions for US corporate law. The 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 business, is obliged, to the same extent as a natural person, to act within the boundaries set by law.<sup>61</sup>

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

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<sup>59</sup> **Obligation to comply.** 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.

<sup>60</sup> **The American Law Institute.** It was established in February 1923 at a meeting in Washington DC of representative judges, lawyers and law teachers.

<sup>61</sup> **Source.** American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (American Law Institute Publishers, 1994) at 55.

act within the boundaries set by law to the same extent as a natural person—no less, but no more.<sup>62</sup>

Courts may take into account the presence or absence of a corporate ‘culture of compliance’ in considering the liability of a company for contravening a regulatory requirement or the penalty for contravention.<sup>63</sup>

### *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 also helps to safeguard the company against reputational and other risks to longer-term shareholder value arising from perceived attempts to flout the 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 focus 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 arguments on points of legal interpretation and precedent are becoming increasingly

<sup>62</sup> **Source.** *id* at 60–61.

<sup>63</sup> **Culture of compliance.** The Commonwealth *Criminal Code* Section 12.3(2), in determining various corporate fault elements, takes into account whether ‘a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision’.

In *ASIC v Chemeq Ltd* [2006] FCA 936 (at para 86), French J referred to the need within a corporation:

to consider regulatory obligations as a routine incident of corporate decision-making. This kind of general sensitivity to the issues underpins what is sometimes called a ‘culture of compliance’. It does not require a risk averse mentality in the conduct of the company’s business, but rather a kind of inbuilt mental check list as a background to decision-making.

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’.

### **2.3.2 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.

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 NGOs entering into formal ‘community-business partnerships’, with stipulated public interest goals and agreed-upon procedures.

Questions may arise about the proper basis for corporate philanthropy. Sir Gerard Brennan, former Chief Justice of the High Court of Australia, identified a tension between corporate donations or other forms of charity and directors’ duties 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.<sup>64</sup>

Similarly, Warren Buffet, chairman 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.<sup>65</sup>

The HII Royal Commission report *The Failure of HII Insurance* (April 2003) touched on issues relating to corporate donations. The Royal Commissioner, Justice Neville Owen, concluded that HII'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.<sup>66</sup>

Justice Owen also said that:

however laudable the object of a donation, discretionary payments of this kind from the funds of shareholders should be undertaken in a transparent and justifiable way with full regard to the interests of shareholders.<sup>67</sup>

On this approach, boards have a discretion to donate corporate assets or engage in other forms of corporate philanthropy, provided this can

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<sup>64</sup> **Source.** Hon. Sir Gerard Brennan, 'Law values and charity' (2002) 76 *Australian Law Journal* 492 at 497.

<sup>65</sup> **Source.** W Buffet, Berkshire Hathaway Inc, Shareholder—Designated Contributions 1981.

<sup>66</sup> **HII Royal Commission report.** vol 1 at p 119.

<sup>67</sup> **HII Royal Commission report.** vol 1 at p 120.

be justified in terms of the company's business interests. Particular donations or other activities may be seen as benefiting the company by promoting its public image, improving staff morale or motivation or enhancing support in relevant communities.<sup>68</sup> However, anonymous corporate donations, or those that secure recognition only for directors or executives personally, rather than the company, are unlikely to be justifiable as in the interests of a company.

### *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.<sup>69</sup>

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.<sup>70</sup>

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

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<sup>68</sup> **Benefits of corporate philanthropy.** According to the report *Giving Australia: Research on Philanthropy in Australia: Summary of Findings* (Commonwealth of Australia, October 2005) (at page x):

For business, giving to non-profit organisations may result in profile or advertising and attract or retain customers (eg via sponsorship). Business may attract staff or improve staff retention rates or skills through employee volunteering or giving programs.

<sup>69</sup> **Source.** American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (American Law Institute Publishers, 1994) vol 1 at 55.

<sup>70</sup> **Source.** 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.

### 2.3.3 Business approach

The business approach to social responsibility, sometimes also described as the ‘enlightened self-interest’ approach, is that, beyond the obligations of companies to comply with environmental and other societal laws (discussed in Section 3.6), it is likely to be in a company’s own commercial interests, in terms of long-term value creation and risk reduction, to take into account the environmental and social context in which it operates.<sup>71</sup>

This perspective challenges any view that there is an inherent incompatibility between the pursuit of shareholder interests and consideration of environmental, social and other concerns:

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<sup>71</sup> **Business case.** The ‘business case’ for social responsibility has been put forward by various commentators. An early example is the World Business Council for Sustainable Development, *Corporate social responsibility: making good business sense* (January 2000).

In *From Challenge to Opportunity: The role of business in tomorrow’s society* (2006), members of the World Business Council for Sustainable Development argue that companies that can develop an understanding of the impacts on them of environmental and social issues, and search for business opportunities, strategies and long-term measures to address those impacts, are most likely to succeed in the future:

We believe that the leading global companies of 2020 will be those that provide goods and services and reach new customers in ways that address the world’s major challenges—including poverty, climate change, resource depletion, globalization, and demographic shifts. If action to address such issues is to be substantial and sustainable, it must also be profitable. Our major contribution to society will therefore come through our core business, rather than through our philanthropic programs (at 4).

Various interest groups also argue the ‘business case’ for what they perceive as socially responsible corporate conduct. For instance, the Australian Conservation Foundation report *False profits: How Australia’s finance sector undervalues the environment* (2006) takes the view that long-term success of financial enterprises is inextricably linked to that of the overall economy and its ecological foundation.

The ASX Corporate Governance Council Paper *Review of the Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006) Part B at paras 21ff summarise some of the economic drivers which underpin the business case for sustainability/corporate responsibility, and how the draft revised Principles 3 and 7 incorporate those sustainability/corporate responsibility elements.

The business case for corporate social responsibility is clear. ... corporate social responsibility is in the best interests of our shareholders and is fundamental to profit creation and sustainability.<sup>72</sup>

The business approach has two key aspects:

- enhancing corporate value or opportunity
- managing corporate risk.

An example of how these two factors may interact concerns the impact of climate change:

For many companies, climate change related issues have the potential to impact financial performance and long-term investment value. The impact of climate change creates both risks and opportunities. Risks may be physical, regulatory, legal, competitive or reputational in nature. Such risks can have a negative impact on a company's investment value through, for example, higher operating costs, reduced profit margins, reduced reputation and associated customer loyalty and/or lower growth forecasts. Alternatively, certain risks/opportunities may deliver, through effective management, positive impacts such as lowered operating costs, higher profit margins, enhancements in reputation and customer loyalty and/or increased rates of growth.<sup>73</sup>

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<sup>72</sup> **Enhancing shareholder value through responsible practices.** The quotation is from an article by CW Goodyear (chief executive of BHP Billiton) 'Social responsibility has a dollar value' *The Age* 27 July 2006, who argued that corporate social responsibility is not a case of shareholder versus stakeholder interests but rather is a critical part of maximising shareholder returns.

CPA Australia *Confidence in Corporate Reporting 2005* reports that some 90% of persons surveyed agreed with the proposition that better management of a company's social and environmental concerns benefits shareholders.

The World Business Council for Sustainable Development paper *From Challenge to Opportunity: The role of business in tomorrow's society* (2006) observed (at 8) that much of the current debate on the role of business in society:

revolves around a misleading distinction between pursuing shareholder value and demonstrating corporate social responsibility. ... Any successful company will both create shareholder value and operate responsibly ... The purpose of any business that seeks to be sustainable has to be more than generating short-term shareholder value.

<sup>73</sup> **Corporate risks and opportunities from climate change.** This quotation is from the Investor Group on Climate Change Australia/New Zealand *Carbon Disclosure Project Report 2006 Australia & New Zealand* (October 2006) at 7–9. That report also drew various conclusions in relation to S&P ASX 100 and NZ 50 companies, including that:

- climate change can significantly impact investment value

Companies that fail properly to consider and manage relevant environmental, social and other impacts of their conduct may, over time, place their commercial future in jeopardy. However, this is not to suggest a necessary correlation between a company's attitude to environmental or social considerations and its financial success or failure. On one view, at least up until now:

Particular firms succeed or fail for many reasons, but exemplary or irresponsible social or environmental performance is rarely among them.<sup>74</sup>

How companies may deal with stakeholder interests and non-financial voluntary reporting under the business approach is discussed in Section 2.4.

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- the nature and extent of exposure to climate change related risks and opportunities varies between companies and, most significantly, between industry sectors
  - Australian and New Zealand companies are responsive to investor interest in climate change related issues
  - companies are generally aware of climate change related risks, but implementation of responses appears limited
  - regulatory uncertainty is an issue for many companies
  - strategic and financial impacts of future climate change regulation are complicated and difficult to quantify for many companies
  - the majority of companies do not have clearly defined internal accountabilities for climate change related issues
  - there was low participation in emissions trading schemes.

Likewise, there is an increasing recognition internationally of the need for companies to consider the effects of climate change, the risks this presents to them and the value creating strategies they can employ to reduce harmful emissions. See, for instance, Ceres *Climate risk toolkit for corporate leaders* (January 2006); Ceres *Corporate governance and climate change: making the connection* (March 2006); Business for Social Responsibility *A Three-Pronged Approach to Corporate Climate Strategy* (October 2006), *Global Framework for Climate Risk Disclosure* (October 2006).

*The Stern Review: The Economics of Climate Change* (October 2006) Chapter 12 argued that a successful transition to a low-carbon emission global economy will help root out existing corporate energy use inefficiencies, while creating new carbon trading markets offering potential sources of growth for energy efficient enterprises.

The implications of climate change for institutional investors and others are discussed at footnote 109.

<sup>74</sup> **Source.** D Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution, 2005) at 41.

### *Enhancing corporate value or opportunity*

Under the business approach to social responsibility, companies need to have regard to environmental and other considerations that bear on their activities, including by:

- adopting policies and practices designed to build broad community as well as consumer 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 sense of social concern and responsiveness that attracts and retains motivated employees, which may lead to improved workplace morale, higher productivity, 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
- working towards achieving 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’.<sup>75</sup> Since then, value creation has increasingly emerged as a theme in the business case for responsible corporate conduct.<sup>76</sup>

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<sup>75</sup> **Source and example.** R Tomasic & S 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.

B McCabe, in ‘Are corporations socially responsible? Is corporate social responsibility desirable?’ (1992) 4 *Bond Law Review* 1, gave the example of 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 products.

<sup>76</sup> **Value creation.** The SustainAbility report *Tomorrow’s Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting* (November 2006) stated that since its 2004 survey, the focus amongst corporations surveyed has expanded to encompass market opportunity, as well as corporate risk, in their sustainability reports:

There is a longstanding debate about whether the adoption of policies that are presented or 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.<sup>77</sup> 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 asset value.<sup>78</sup>

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On current evidence.....the links between the evolving sustainability agenda and wider market opportunities are now better understood (at 2).

<sup>77</sup> **Research into financial impact.** 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). An analysis of quantitative studies by M Orlitzky, F Schmidt & S Rynes, 'Corporate Social and Financial Performance: A Meta-analysis' (2003) *Organization Studies* 24(3) 403, concluded (at 403) that 'the meta-analytic findings suggest that corporate virtue in the form of social responsibility and, to a lesser extent, environmental responsibility, is likely to pay off'.

*Sustainability Reporting: Practices, Performance and Potential* (July 2005), a research project commissioned by CPA Australia and conducted 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.

D Vogel in *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution, 2005) argues (at 33) that while the academic research on the relationship between corporate responsibility and profitability is inconclusive:

the effort to demonstrate through statistical analysis that corporate responsibility pays may be not only fruitless, but also pointless and unnecessary, because such studies purport to hold corporate responsibility to a standard to which no other business activity is subject. For example, it is highly unlikely that there is a positive correlation between advertising expenditure and corporate profitability; some profitable firms spend little on advertising, and many advertising expenditures produce disappointing results. Yet no one would dispute that there is a business case for advertising.

<sup>78</sup> **Measuring intangible assets.** As pointed out in Business for Social Responsibility *Business Brief: Intangibles and CSR* (February 2006) (at 2), intangible assets, including corporate reputation and community support, while fundamental to strong financial performance, 'are poorly articulated, normally unmeasured and rarely reported'. The report concluded (at 9) that:

The link between intangibles and CSR is intimate and multifaceted. Understanding how value is created through intangible assets is integral to understanding how long-term wealth is created through CSR.

However, a view appears to be emerging that taking environmental and social matters into account does not detract from investment performance.<sup>79</sup>

### *Managing corporate risk*

The business approach to social responsibility also comprehends the view that a well-managed company will have regard to a variety of risk factors that impinge on its operations, including relevant social and environmental risks. These risks will differ between companies and commercial sectors.<sup>80</sup> The early identification and proper management of non-financial risks may be integral to a company's operational efficiency, its overall financial performance and its

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There are some initiatives towards measuring these intangible assets in monetary terms, such as *The ADVANCE Guide to Sustainable Value Calculations* (2006), published by the University of St. Andrews and the Institut für Zukunftsstudien und Technologiebewertung gGmbH as part of the ADVANCE project.

<sup>79</sup> **Source.** ASX Corporate Governance Council Paper *Review of the Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006) Part B at para 25.

<sup>80</sup> **Differing risk profiles.** Risk profiles of companies are likely to differ between commercial sectors. The risks associated with mineral extraction, for instance, may differ materially from those for a financial services provider.

Multinational corporations are also likely to have a different risk profile than national ones. B Kytte & 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.

long-term shareholder value.<sup>81</sup> 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 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.<sup>82</sup>

The management of non-financial risks may not necessarily maximise profits or shareholder wealth in the short term or eliminate operational risk. However, failure by a company to identify and properly manage these risks may cause considerable detriment, such as:

- increased direct or indirect operating costs
- regulatory intervention in response to the damage caused by uncontrolled risk

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<sup>81</sup> **Litigation risk.** 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 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.

The report points to 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.

<sup>82</sup> **Source.** ACSI Paper, *Corporate social responsibility: guidance for investors* (September 2005) at 15.

- harm to corporate reputation or brand image, including adverse litigation<sup>83</sup>
- reduced employee loyalty or community support.

An 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.<sup>84</sup> Changes in corporate risk profile could also affect a company's credit rating<sup>85</sup> and directors and officers insurance policies.<sup>86</sup>

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<sup>83</sup> **Reputation risk.** 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.

<sup>84</sup> **Power to remove directors.** Corporations Act ss 203C, 203D. Shareholders may also undertake class actions against directors.

<sup>85</sup> **Credit ratings.** For instance, Standard & Poor's indicated in 2006 that they are to incorporate enterprise risk management (ERM) into their credit ratings of Australian and New Zealand industrial and infrastructure companies.

<sup>86</sup> **Impact on D&O insurance.** B Kytte & 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.

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.

The various forms of non-financial risk and their impact on corporate performance have been recognised internationally,<sup>87</sup> and nationally,<sup>88</sup> though assessing what constitute material environmental and other societal risks can be a more subjective and

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<sup>87</sup> **Increasing international attention to non-financial risks.** The *United Nations Environment Programme (UNEP) Statement by Financial Institutions on the Environment & Sustainable Development*, signed by a number of 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 various worldwide insurers, states that the signatory insurers:

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).

The UK *Turnbull Report* (1999) urged boards of companies to focus on risk management and control, with risk being interpreted in a broad sense to include environmental and social matters. Subsequently, the Association of British Insurers issued a document, *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. The UK-based Ethical Investment Research Services report *SEE risk management: a global analysis of its adoption by companies* (December 2005) observed (at 2) that:

non-financial risks have a potentially damaging impact on the financial health of the company and ultimately on shareholder value ... Conversely, well managed SEE [social, environmental and ethical] risks may bring opportunities and benefits to a company by enhancing its reputation and ultimately increasing shareholder value.

<sup>88</sup> **Attention to non-financial risk in Australia.** Ernst & Young, in its report for the Department of the Environment and Heritage *The Materiality of Environmental Risk to Australia's Finance Sector* (2003), observed (at 2) that its research had 'revealed a notable absence of known examples in Australia where finance sector participants are aware of having suffered substantial financial losses due to environmental exposures. This is considered one of the main reasons why the debate on materiality or significance of environmental risk to Australia's finance sector is not as advanced as the UK, Europe and USA'.

It appears, however, that attention to non-financial risk may be growing in Australia, particularly on the part of superannuation funds and other long-term institutional investors, as explained in Section 2.4.1.

difficult exercise than assessing conventional financial risks.<sup>89</sup> Also, the degree to which companies adopt non-financial risk management practices differs between corporate sectors, as well as between

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<sup>89</sup> **Measuring non-financial risk.** Various studies have acknowledged that pricing non-financial risk is difficult: Ernst & Young, *The Materiality of Environmental Risk to Australia's Finance Sector* (2003), *The Operating and Financial Review Working Group on Materiality* (UK, 2003), ABN AMRO *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing—11 Sector Studies* (2004) at 15.

Notwithstanding the challenge, there appears to be 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.

The Freshfields report stated that 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. The report considered that accounting standards and systems should be altered to account for such intangibles.

The UK-based Ethical Investment Research Services report *SEE risk management: a global analysis of its adoption by companies* (December 2005) set out a framework for assessing a company's social, environmental and ethical (SEE) risk management system. The report concluded that its SEE risk management framework 'offers something to a range of analysts whether they are driven by governance, ethical, financial or engagement concerns'.

The *Enhanced Analytics Initiative* (EAI) was established in Europe in 2004 by a group of major asset owners and fund managers to integrate environmental, social and other non-financial matters into their research and analysis, including the impact of non-financial matters on long-term corporate performance.

countries.<sup>90</sup> Also, the range or types of non-financial risks and their impact on operations may change over time.<sup>91</sup>

There is no general requirement in Australian law for companies to have risk management systems.<sup>92</sup> However, in relation to listed public companies, the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* Principle 7 (Recognise and manage risk) is consistent with the risk management approach to corporate social responsibility. The draft reformulated Principle 7 (November 2006) (which is an elaboration of the risk management approach in the original Principle 7) states, in part, that:

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<sup>90</sup> **Measuring non-financial risk in different sectors.** The Ethical Investment Research Services report *SEE risk management: a global analysis of its adoption by companies* (December 2005) provides data on social, environmental and ethical (SEE) risk management practices by corporations according to industry sector and country. The report found a similar level of use of SEE risk management practices by Australian, New Zealand, Canadian and European companies.

On the positive side there are signs that companies in many parts of the developed world are taking up the challenge of identifying and managing their SEE risks. However, the evidence is clear that a large number of companies still need to take a number of further steps to address these matters in a coherent way. Overall, the data shows that there are more companies who have yet to establish identifiable SEE risk management systems than there are demonstrating that they have some key aspects in place (at 13).

<sup>91</sup> **Range of non-financial risks.** 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.

<sup>92</sup> **Specific risk management requirements.** There are specific risk management requirements for a limited class of entities.

Financial services licensees must have an adequate risk management system (s 912A(1)(h) of the Corporations Act). 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.

APRA-regulated entities must develop, implement and maintain a sound and prudent risk management framework dealing with financial and non-financial material risks. APRA Guidance Note GGN 220.2 (July 2002) deals with risk management requirements for insurers, and APRA Superannuation Guidance Note SGN 120.1 (July 2004) 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. 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.

Companies should establish a sound system of risk oversight, risk management and internal control.

Risk management is the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects.

A risk management system should be designed to

- identify, assess, monitor and manage risk
- identify material changes to the company's risk profile.

This structure can enhance the environment for identifying and capitalising on opportunities to create value.

According to the Commentary and Guidance on the draft reformulated Principle 7:

When establishing and implementing its system of risk management a company should consider all material business risks. These risks may include but are not limited to:

- financial reporting risks—the risk of a material error in the financial statements
- other risks, such as operational, environmental, sustainability, compliance, strategic, external, ethical conduct, reputation or brand, technological, product or service quality and human capital which if not properly managed will affect the company.

Principle 7 also refers to listed public companies disclosing their risk management and internal control systems. However, the level of reporting on these matters since the introduction of the Principles in 2003 has been limited. According to the Council:

one reason for the low standard of reporting against Principle 7 generally may be that risk management reporting is still a relatively new phenomenon for many companies. To be in a position to report effectively about its risk management and internal control systems—and in particular to identify any material deficiencies in their systems—companies must have undertaken a number of processes. For example, companies must first identify risks, monitor those risks, measure their risk exposure, manage their risks, develop and implement procedures to ensure that their risk management systems are working and finally make

decisions about how they will report and whether they will have these reports audited or reviewed.<sup>93</sup>

The Corporate Governance Council principles and recommendations are not obligatory for listed companies, though companies that choose not to follow one or more of them must identify in their annual report what they have not followed and give reasons for departing from them (the ‘if not, why not’ reporting requirement).<sup>94</sup>

### 2.3.4 Social primacy approach

This approach to social responsibility calls on directors to take various ethical values or goals (going beyond the spirit of the law) into account in their corporate decision-making, whether or not this enhances corporate profit or shareholder gain. An example might be a decision by directors not to engage in certain commercial activities because of the perceived social harm, regardless of the corporate opportunities or potential profits forgone, or not to deal with any organization that fails to meet certain environmental or social standards.

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<sup>93</sup> **Source.** ASX Corporate Governance Council Consultation Paper *Review of the Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006) Part A at para 70.

<sup>94</sup> **Rationale of the ‘if not, why not’ reporting requirement.** 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 recommendations of the ASX Corporate Governance Council in the reporting period, identifying any recommendations that they have not followed, and giving reasons for not following them (known as the ‘if not, why not’ reporting requirement). According to the ASX Corporate Governance Council in the foreword to its *Principles of Good Corporate Governance and Best Practice Recommendations* (March 2003):

The size, complexity and operations of companies differ, and so flexibility must be allowed in the structures adopted to optimise individual performance.

That flexibility must, however, be tempered by accountability—the obligation to explain to investors why an alternative approach is adopted—the ‘if not, why not’ obligation.

The ASX Corporate Governance Council *Consultation Paper* (November 2006) states (at para 21 of Part A) that the Council remains committed to the Principles as ‘non-prescriptive’ and that the ‘if not, why not’ approach remains central to the philosophy of the Council:

The inherent flexibility of the ‘if not, why not’ approach allows companies which consider the Principles and Recommendations too detailed, not to follow them, provided they explain why.

See further ss 793C and 1101B of the Corporations Act regarding the enforcement of ASX Listing Rules.

The American Law Institute (ALI) *Principles of Corporate Governance* model clause 2.01(b)(2) provides:

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 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.<sup>95</sup>

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 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.<sup>96</sup>

### 2.3.5 Social obligation 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 has an obligation to assist in solving social problems and advancing public welfare, even in the absence of a discernible benefit to the company in so doing.<sup>97</sup> On this view, corporate status

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<sup>95</sup> **Source.** at 63.

<sup>96</sup> **Source.** *ibid.*

<sup>97</sup> **Solving social problems.** This idea that corporations should be involved in solving social problems 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'.

is a form of gift from the state that has to be earned through the fulfilment of social and moral duties.

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 could ... be 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 generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation.<sup>98</sup>

## 2.4 Relevant concepts

Concepts that are commonly referred to in the discussion of the above-mentioned approaches are:

- stakeholders
- sustainability
- triple bottom line reporting.

### 2.4.1 Stakeholders

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

The term has no precise or commonly agreed meaning. Possible definitions range from ‘groups vital to the success and survival of a

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<sup>98</sup> **Source.** J Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press, Oxford, 1994) at 79 and 261.

corporation'<sup>99</sup> to 'any individual or group who can directly or indirectly affect, or be affected by, that entity'<sup>100</sup> to 'any person, group or organization that can place a claim on a company's attention, resources or output'.<sup>101</sup> Possibly the most inclusive definition of stakeholders of an organization is:

those groups or individuals that: (a) can reasonably be expected to be significantly affected by the organisation's activities, products and/or services; or (b) whose actions can reasonably be expected to affect the ability of the organisation to successfully implement its strategies and achieve its objectives.<sup>102</sup>

The term can therefore 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)

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<sup>99</sup> **Stakeholder definition.** 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.

<sup>100</sup> **Further definitions.** According to R Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984) 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 *Draft UN Norms for 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.

<sup>101</sup> **Source.** B Kyle & J Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005) at 3.

<sup>102</sup> **Source.** Global Reporting Initiative *G3 Sustainability Reporting Guidelines* (2006).

- pressure groups or NGOs, usually characterised as public interest bodies that espouse social goals relevant to the activities of companies.<sup>103</sup>

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 construe the role of stakeholders in corporate decision-making.

### *Business approach to stakeholders*

As part of the business approach (outlined in Section 2.3.3), it is generally 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 interest groups, not just focus on immediate returns to shareholders. This approach challenges any assumption that the wealth of shareholders can only be maximised by sacrificing the interests of others.<sup>104</sup>

Companies must comply with all relevant laws that affect or protect the interests of stakeholders (see Section 3.6). Beyond that, and subject to directors acting in the interests of the company (see Sections 3.2 and 3.3) and stakeholders enforcing contractual or other legal rights,<sup>105</sup> it is a matter for the commercial judgment of directors, under the business approach, to determine what stakeholder interests to consider in particular situations and how to

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<sup>103</sup> **Stakeholder definitions.** 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, D Wood, 'Whom should business serve?' (2002) 14 *Australian Journal of Corporate Law* 266, Dr G Zappalà, 'Corporate Citizenship and the Role of Government: the Public Policy Case', Research Paper No.4 2003–04, Politics and Public Administration Group, 2003 at 5.

<sup>104</sup> **Interests of shareholders and others not incompatible.** Various commentators have pointed out that corporate decision-making is not a form of 'zero-sum' game in which the interests of one group can only be advanced at the expense of another group. See, for instance, the view of E Orts, a leading US commentator on corporate governance, in 'Beyond shareholders: interpreting corporate constituency statutes' (1992) 61.1 *George Washington Law Review* 14 at 72–73.

<sup>105</sup> **Contractual rights of stakeholders.** For instance, a creditor under the terms of a particular contractual covenant may be entitled to exercise an increased influence over corporate decision-making in particular situations, such as where the company has defaulted on one or more of its obligations under the contract.

manage, balance or prioritise them, taking into account that stakeholders may have conflicting interests.

The American Law Institute in its *Principles of Corporate Governance* 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.<sup>106</sup>

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 to stakeholders, and concern over corporate reputation and corporate performance often requires the recognition of broader interests.<sup>107</sup>

Stakeholders under this business 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

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<sup>106</sup> **Source.** American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* vol 1 (American Law Institute Publishers, 1994) at 57.

<sup>107</sup> **Source.** OECD *Principles of Corporate Governance* at 46.

the stakeholders would mean identifying the various stakeholder groups; and deciding the nature and extent of the directors' responsibility to each. The 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.<sup>108</sup>

Shareholders generally can exert influence through the internal corporate governance structure, as further discussed in Section 3.1.

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, including managed investment fund managers, may seek to have companies more closely examine and disclose how they are identifying and dealing with their longer-term environmental, social and governance (ESG) risks and opportunities and the effects of these matters on corporate financial viability. An example is in relation to the impact of climate change.<sup>109</sup> The way companies deal with these longer-term ESG matters may

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<sup>108</sup> **Source.** UK Hampel Committee *Corporate Governance* at 1.17.

<sup>109</sup> **Implications of climate change.** Climate change may also be of increasing importance to institutional investors, who are seeing the need to consider the risks and opportunities associated with global warming for the companies in which they may invest. See, for instance, *Ceres Investor Guide to Climate Risk* (July 2004) and *The Institutional Investor Summit on Climate Risk: Final Report* (October 2005). The *Global Framework for Climate Risk Disclosure* (October 2006) was prepared by a group of institutional investors from around the world to set out information that they would require of any company in which they would invest in order to analyse its business risks and opportunities resulting from climate change, as well as its efforts to address those risks and opportunities:

Climate risk disclosure is a burgeoning field, as companies, investors, governments and civil society increasingly understand the risks and opportunities that climate change poses for companies and investors (at 2).

See also *Using the Global Framework for Climate Risk Disclosure* (October 2006), which provides a guide for companies to assist in disclosing climate risk to investors, including examples of such disclosures from leading corporations.

In regard to insurance, the report by Lloyd's 360 Risk Project, *Climate change: adapt or bust* (2006), argues that the insurance industry needs more fully to understand and manage climate change insurance risk. The report by Ceres *From Risk to Opportunity: How insurers can proactively and profitably manage climate change* (August 2006) identifies a range of initiatives by insurance companies to encourage insured entities to reduce greenhouse gas emissions and thereby lessen the financial risks to insurers.

have significant implications for their ability to attract equity or loan capital.<sup>110</sup>

This approach challenges any notion that companies should be assessed only against market benchmarks based on short-term financial performance and profit outcomes. While immediate financial returns are important to many 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.<sup>111</sup> This raises the more general issue of

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<sup>110</sup> **Factoring ESG considerations into investing.** A report by Mercer Investment Consulting *Fearless Forecast 2006: What do investment managers think about responsible investment* (March 2006) indicated that almost 75% of a sample of investment management firms from around the world were of the view that measuring corporate performance against ESG indicators would become a mainstream investment activity within a decade.

<sup>111</sup> **Focus on longer-term considerations.** *Corporate Sustainability—an Investor Perspective* (Department of the Environment and Heritage, 2003) (the Mays report) pointed out (at 18) that:

Long term investors such as superannuation and insurance funds are most exposed to the social and environmental risks embedded in the companies in which they invest. The relative concentration of the Australian sharemarket and the widespread use of benchmark indices in investment means that as they grow, institutional investors increasingly become permanent owners of shares in companies. Sustainability considerations particularly benefit these long term investors.

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

A report by the UN Environment Program Finance Initiative *Show me the money: Linking Environmental, Social and Governance Issues to Company Value* (July 2006) observed that institutional investors who choose to integrate environmental, social and governance (ESG) issues into their portfolio management may do so for different, sometimes overlapping, reasons:

- to maximise financial returns (applying the hypothesis that a more thoroughgoing and systematic approach to integrating ESG issues in investment portfolios will, over time and in general, result in better financial performance)
- to act in accordance with personal ethics (regardless of whether such application results in marginally positive or negative impacts to financial performance), and
- to further societal goals (that is, to channel investment flows in a manner that is more consistent with the goals of sustainable development than is generally the case).

The report focused on the first reason. It presented (at 5) evidence across eight industry sectors of a direct link between attention to ESG issues, financial value and company profitability:

how best to achieve a balance between short-term and long-term considerations.<sup>112</sup>

- fund managers may, where relevant in their investment decisions, take into account whether companies meet certain environmental, social and corporate governance standards.<sup>113</sup>

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The material contained in this document provides strong independent support for the view that effective attention to [ESG] issues will enhance shareholder value. Investors who do not pay attention to [ESG] issues are taking unnecessary risks with their portfolios. Investors who do pay attention are probably improving the risk/return relationship.

Various commentaries have sought to explore ways to enable companies to focus on long-term interests of their business, rather than primarily on their short-term share prices, including, for instance, the Universities Superannuation Scheme Ltd, *Enhanced Analytics for a New Generation of Investor: How the Investment Industry can use Extra-financial factors in Investing* (2006).

<sup>112</sup> **Short-termism.** Concerns have been raised from time to time about whether there is an undue focus by some companies and investors on short-term performance at the expense of long-term strategic planning. The Business Council of Australia report *Seen between the lines—looking beyond the horizon* (October 2004) concluded (at 1) that ‘short-termism is increasingly a driver of market behaviour and a potential constraint on longer-term value creation’. The US Business Roundtable Institute for Corporate Ethics report *Breaking the Short-term Cycle* (July 2006) proposed various practical measures to reduce any over-emphasis on short-termism, including aligning corporate executive compensation with long-term goals and strategies, and communicating these objectives and related performance benchmarks to investors, advisers and shareholders. R Elstone, E Johnstone and C Macek, in ‘Some challenges for directors in short-termism’ *Company Director* Vol 22 No 9, October 2006, at pp 38–39, summarised some of these possible practical steps. This matter is further discussed in footnotes 157 and 158 and related text.

<sup>113</sup> **Duties of fund managers.** A report, commissioned by the UN Environment Program Finance Initiative, by 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 countries permitted or required fund managers to include environmental, social and governance (ESG) factors in their investment decision-making or prevented them from so doing. The report stated that the first and foremost duty of fund managers is not simply to maximise returns to members in the short term but to implement an investment strategy that is rational and appropriate to the fund’s overall needs and aspirations. In so doing, fund managers should consider ESG matters where these are likely to have a material financial impact on the fund:

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 Freshfields 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, ‘confusion over whether ESG is consistent with fund managers’ fiduciary responsibilities’, though:

Under one approach, usually referred to as socially or sustainable responsible investing (SRI),<sup>114</sup> funds base their investment decisions on stated environmental or other social factors. This process has been assisted by the development of various corporate social responsibility market indices.<sup>115</sup> Also,

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recent Australian commentary suggests that where an investment decision has been made on the basis of a modern portfolio approach, which justifies the inclusion of a variety of risky and non-risky investment options provided the overall investment yields a positive financial result, a fiduciary will not be in breach of its obligations and may safely pursue an ESG strategy.

In the USA, this matter is dealt with under the 'prudent investor rule', which is a legal doctrine to provide guidance to investment managers on the standards for managing an investment portfolio in a legally satisfactory manner: see further R Aalberts & P Poon, 'The new prudent investor rule and modern portfolio theory: a new direction for fiduciaries' *American Business Law Journal* Fall 1996 at 39–71; E Maloney, 'The investment process required by the Uniform Prudent Investment Act' *Journal of Financial Planning* November 1999.

<sup>114</sup> **SRI investing.** Investment funds based on SRI principles limit their investment portfolios to companies that are perceived to meet certain ethical, social and environmental standards. Arguably, companies that are excluded from these funds may be under pressure to change any conduct that the promoters of those funds consider is objectionable.

A useful summary of the history of the SRI movement is found in the ACSI 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) also contains a summary of initiatives from various jurisdictions that have promoted SRI.

Various associations have been formed in different countries, including in the USA (Social Investment Forum), the UK (UK Social Investment Forum), the EU (European Social Investment Forum (Eurosif)) and Australia (Ethical Investment Association), 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 reports by AMP Capital Investors *Financial payback from environmental & social factors* (April 2005) and by the Ethical Investment Association *Sustainable responsible investment in Australia 2005* refer to some evidence that SRI investing leads to superior portfolio performance over the longer term.

The Financial Services Institute of Australia, in its report *Consumer Research: Sustainable & Responsible Investing* (September 2006) stated (at 8) that it 'aims to design an effective consumer toolkit that illustrates how SRI investments differ from mainstream investments'.

The Eurosif report *The 2006 European SRI Study* (October 2006) gives an overview of the developing EU SRI market, which, in 2006, represented 10–15% of the total European funds under management (a 36% growth since 2002).

<sup>115</sup> **Corporate social responsibility indices.** 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 Corporate Responsibility Index, the Sustainable Asset Management Index and the RepuTex SRI Index. These are further discussed in Section 5.3.3.

the UN *Principles for Responsible Investment* (2006), to which some Australian superannuation funds are signatories, seek to encourage institutional investors to incorporate environmental, social and corporate governance (ESG) factors into their investment decisions.<sup>116</sup> Likewise, some investment intermediaries are encouraged to assess the conduct of companies by reference to various labour, environmental, social and ethical criteria.<sup>117</sup>

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<sup>116</sup> **UN Principles for Responsible Investment.** These principles were developed through the work of various pension funds, other institutional investors and experts. They are intended to be adopted by institutional investors, rather than by nation states, on a voluntary basis. According to the Preamble:

There is a growing view among investment professionals that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios. Investors fulfilling their fiduciary (or equivalent) duty therefore need to give appropriate consideration to these issues, but to date have lacked a framework for doing so. The Principles for Responsible Investment provide this framework. The Principles are voluntary and aspirational. They are not prescriptive, but instead provide a menu of possible actions for incorporating ESG issues into mainstream investment decision-making and ownership practices.

<sup>117</sup> **Information in product disclosure statements.** The Corporations Act s 1013D(1)(l), introduced in 2002, requires issuers of investment products (such as superannuation products, managed investment products and investment life insurance products) to include in their product disclosure statements ‘the extent to which labour standards or environmental, social or ethical considerations are taken into account in the 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). According to the guidelines:

you must disclose which of these standards and considerations you take into account and how. If you have no predetermined approach, then this too must be clear. The more a product is marketed on the basis that such standards and considerations are taken into account, the more detail is required.

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, taking into account s 945A, should form a view about how far to inquire whether environmental, social or ethical considerations are important to their clients and, if so, conduct reasonable inquiries about those matters (PS175.110).

The requirement in s 1013D(1)(l) 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 into 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.

- 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.<sup>118</sup> 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.<sup>119</sup> 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.

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<sup>118</sup> **Social risk.** B Kytte & J Ruggie, in *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.

<sup>119</sup> **Consumer risk.** The OECD paper *Informing consumers on CSR in international trade* (November 2006) points out (at 3) that 'developments in OECD markets show that consumers increasingly attach importance to how companies they buy from conduct their business, and that the voluntary adoption of CSR policies is spreading in the private sector in response to concerns from consumers and other stakeholders'.

B Kytte & J Ruggie, in *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005), outline 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.<sup>120</sup>

Some credit rating agencies are factoring in a company's performance on stakeholder-related matters in assessing a company's creditworthiness.<sup>121</sup>

The Australian Stock Exchange (ASX) Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* are consistent with the business

<sup>120</sup> **Stakeholder engagement.** B Kytte & J Ruggie, in *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Kennedy School of Government, Harvard University (March 2005), 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* (2005). This complements *The Stakeholder Engagement Manual, vol 1* (2005) published by Stakeholder Research Associates Canada.

AccountAbility has also published an exposure draft *Stakeholder Engagement Standard* (AA1000SES) (September 2005).

The report by AccountAbility *What Assures?* (June 2006), which examined the impacts and implications of stakeholder demand for assurances about companies' products, practices and performance, notes that confidence in a company is often as much to do with the willingness of the organization to engage with stakeholders as with the content of any formal assurances. The report also observed (at 4) that 'one of the greatest challenges for business today is to decide which stakeholders count most'.

<sup>121</sup> **Credit ratings include non-financial factors.** 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'.

Standard & Poor's indicated in 2006 that they are to incorporate enterprise risk management (ERM) into their credit ratings of Australian and New Zealand industrial and infrastructure companies. They described ERM as essential to good corporate governance and to managing stakeholder expectations.

approach to stakeholders. Draft reformulated Principle 3 (Promote ethical and responsible decision-making) (November 2006) recognises that:

To be successful, companies need to have regard to their legal obligations and the interests of a range of stakeholders including shareholders, employees, business partners, creditors, consumers, the environment and the broader community in which they operate. It is important for companies to demonstrate their commitment to appropriate corporate practices and decision making.

It recommends that listed companies establish and disclose a code of conduct covering various matters, including ‘the practices necessary to take into account their legal obligations and the expectations of their stakeholders’. These stakeholder expectations are elaborated upon in the Council suggestions for the content of a code of conduct for the purposes of Principle 3.

A comparable observation is made in the Commentary and Guidance on the draft reformulated Principle 7 (Recognise and manage risk):

The company’s risk management policy should take into account its legal obligations and the expectations of its stakeholders. ... Failure to identify and address the expectations of the community or other stakeholders can threaten a company’s reputation and the success of its business operations. Effective risk management involves considering factors which bear upon the company’s continued good standing with its stakeholders and the community.

### *Broader obligation approach to stakeholders*

From time to time, suggestions have been made that go beyond the business approach to the treatment of stakeholders by proposing that companies should be run for the benefit of all stakeholders, with directors being accountable to all of them.<sup>122</sup> Also, stakeholders generally, not just shareholders, should be given some right to

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<sup>122</sup> **Accountability to stakeholders.** These ideas are referred to in E Sternberg, *Corporate Governance: Accountability in the Marketplace* (Institute of Economic Affairs, London, 2004) at 127–128.

participate in corporate decision-making (going beyond 'engagement' mechanisms).<sup>123</sup>

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. These matters are further discussed in Chapter 3.

## 2.4.2 Sustainability

The concept of sustainability or sustainable development has a broad socio-political dimension and a more specific corporate dimension.

### *Socio-political dimension*

According to the most widely used description of sustainable development, known as the Brundtland definition:

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.<sup>124</sup>

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<sup>123</sup> **Stakeholder participation in decision-making.** A useful summary, and critique, of this representative stakeholder model of corporate decision-making is given by H Hansmann & R Kraakman in 'The end of history for corporate law' (2001) 89 *Georgetown Law Journal* 439. They argue (at 440–441) that this stakeholder participation model is contrary to an emerging international consensus that groups other than shareholders should not have a direct involvement in corporate decision-making:

The principal elements of this emerging consensus are that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance.

G Acquah-Gaisie, in 'Toward more effective corporate governance mechanisms' (2005) 18 *Australian Journal of Corporate Law* 1, 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, comprising a supervisory board, with employee representatives, which is concerned with fundamental policy decisions, and a management board, which is responsible for the day-to-day management of the company.

This approach is based on the view that economic development without regard to, and at the cost of, the environment, including the effects on natural resources, eco-systems and climate, could only be overcome by integrating environmental and social concerns with economic goals.

Much of this 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 and how this might best be managed in the future.<sup>125</sup> For instance, it was agreed at the World Summit on Sustainable Development in Johannesburg in 2002 that efforts need to be taken to:

promote the integration of the three components of sustainable development—economic development, social development and environmental protection—as interdependent and mutually reinforcing pillars.

The EU has developed, and continues to refine, its sustainable development strategy for EU member states, with broad socio-political objectives related to environmental protection, social equity and cohesion, and economic prosperity.<sup>126</sup>

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<sup>124</sup> **Background to the Brundtland definition.** In 1987, the UN 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.

<sup>125</sup> **History.** 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 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.

A useful analysis of the views of international experts regarding global progress on achieving sustainable development is *GlobeScan Survey of Sustainability Experts* (September 2005). That survey also includes a list of factors that experts consider may influence future corporate behaviour in regard to sustainable development.

<sup>126</sup> **Importance of sustainability in EU.** The Council of the European Union *Renewed EU Sustainable Development Strategy* (June 2006) states that sustainable development 'is an overarching objective of the European Union set out in the Treaty, governing all the Union's policies and strategies'. That paper summarises the EU sustainability objectives and policy guiding principles.

There are also international industry-based<sup>127</sup> and trade union<sup>128</sup> sustainability initiatives.

This notion of sustainability or sustainable development has also been adopted in Australian legislation. In *Telstra Corporation Limited v Hornsby Shire Council* [2006] NSWLEC 133, the NSW Land and Environment Court considered the concept of ‘ecologically sustainable development’, as included in various environmental and planning statutes. The Court observed, at [107] ff, that this concept involves various elements based on internationally recognised sustainability principles.

### *Corporate dimension*

The concept of sustainability has also been increasingly applied by companies in recognising that their own viability as a long-term business depends, in addition to their financial performance, on responsible management of the environmental and social impact of their conduct.<sup>129</sup>

The other principal development for corporations is sustainability reporting, involving the communication by organizations of their environmental, social and economic performance. This is discussed below.

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<sup>127</sup> **Industry-based sustainability initiatives.** The World Business Council for Sustainable Development report *Powering a Sustainable Future* (October 2006) argues the need for changes in the manner of generating energy, to avoid serious global consequences.

The Advisory Committee further discusses voluntary industry and government-industry sustainability initiatives in Chapter 5.

<sup>128</sup> **International trade union based sustainability initiatives.** See, for instance, the International Trade Union Confederation (ITUC) Congress Resolution (November 2006) and the Background Report *The Workbook*, which outline priorities for the international trade union movement in regard to various sustainability matters.

<sup>129</sup> **Sustainability in the corporate context.** 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).

### 2.4.3 Sustainability/triple bottom line reporting

#### *The concept*

The origins of sustainability or triple bottom line reporting (sometimes referred to by other terms, including ‘non-financial reporting’,<sup>130</sup>) 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. This form of voluntary reporting evolved during the 1990s to complement conventional financial reporting and focuses on the environmental, social and economic impact of corporate activities.<sup>131</sup> In essence:

Sustainability or non-financial reporting involves companies assessing their performance against environmental, social and economic criteria, how these results relate to the success of the business, and how potential impacts, opportunities and risks are addressed.<sup>132</sup>

The standards and guidelines that have been developed for sustainability or triple bottom line reporting tend to focus on descriptive, rather than quantitative, reporting. Also, there is an

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<sup>130</sup> **Nomenclature.** The SustainAbility report *Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting* (November 2006) pointed out that how these reports are described can vary by region, by industry and by company:

Among current favourites: corporate responsibility, CSR, extra-financial, GRI-style, environmental social and governance (ESG), non-financial, social and environmental performance and sustainability reporting.

The report commented that with the introduction of the Global Reporting Initiative, including G3, launched in October 2006, ‘sustainability’ reporting seems to have gathered support.

<sup>131</sup> **Triple bottom line reporting.** The concept of triple bottom line reporting was first employed by SustainAbility in 1996 with *Engaging Stakeholders* and was explained by J Elkington (of SustainAbility) in *Cannibals With Forks: The Triple Bottom Line of 21st Century Business* (Capstone Publishing Limited, Oxford, 1997). The principles are summarised in Chapter 4 of the book. 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.

The notion of triple bottom line reporting was also promoted by the international business organization, World Council for Sustainable Development.

<sup>132</sup> **Source.** Media release of the Minister for the Environment and Heritage, Senator the Hon. Ian Campbell, 24 March 2006.

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 its financial statements.

The mixture of environmental, social and economic factors may differ between companies. For instance, mining companies and financial services businesses may have different impacts on the environment.

Companies that decide to prepare sustainability or triple bottom line reports may choose to include them in their annual reports or, as is often the case, present them as stand-alone reports.

### *GRI Guidelines*

The Global Reporting Initiative (GRI) is increasingly being recognised as a global benchmark for voluntary sustainability or triple bottom line reporting. Other voluntary frameworks that complement or refer to the GRI in specific areas include the *UN Global Compact* (which expects participants annually to submit a 'Communication on Progress' using reporting indicators such as the GRI), as well as the *Carbon Disclosure Project* and the *Global Framework for Climate Risk Disclosure*, both of which deal with corporate aspects of climate change. Other international organizations have published material to complement and assist in implementing the GRI guidelines.<sup>133</sup>

The first GRI Sustainability Reporting Guidelines were released in June 2000. Revised Guidelines were introduced in September 2002. Further revised Guidelines, known as G3, commenced in October 2006.

The GRI reporting framework consists of the Sustainability Reporting Guidelines, the Technical Protocols and the Sector Supplements. Companies choosing to adopt them must:

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<sup>133</sup> **Eco-efficiency indicators.** The UN 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 eco-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.

- provide a description of their governance and management systems to show how they manage their sustainability
- assess and report on the environmental, social and economic effects of their activities by reference to various environmental, social and economic performance indicators.<sup>134</sup>

The GRI guidelines have been designed to allow for their incremental adoption by companies, through a system of reporting levels to reflect the extent of their application.

A growing number of larger companies in OECD countries are voluntarily reporting on social and environmental issues, using the GRI or other sustainability guidelines.<sup>135</sup> Some larger Australian

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<sup>134</sup> **GRI definitions.** According to the *G3 Sustainability Reporting Guidelines* (2006):

- *environmental performance* means an organization's impact on living and non-living natural systems, including eco-systems, land, air and water
- *social performance* means an organization's impact on the social system within which it operates. This includes labour practices, human rights and other issues affecting consumers, the community and other stakeholders in society
- *economic performance* means an organization's impact on the economic resources of its stakeholders and on economic systems at the local, national and global levels.

<sup>135</sup> **Uptake of GRI globally.** KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* (June 2005) 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 (being the top 250 companies of the Fortune 500) and 33% of National 100 companies (being the top 100 companies in 16 countries) now provide some form of corporate responsibility report. In addition, 40% of sustainability reports worldwide mentioned the use of GRI guidelines.

The report by Context *Reporting in Context: Global Corporate Responsibility reporting trends 2006* indicates that an increasing number of leading global companies are voluntarily reporting on social and environmental issues, including a majority of the US top 100 public companies and 90 of Europe's top 100 corporations. There is also a steady increase in the level of voluntary disclosure, in some form, of sustainability information by Canadian listed companies, going from 35% of companies on the Toronto Stock Exchange Composite Index in 2000 to 70% of those companies in 2005: *Corporate Sustainability Reporting in Canada* (December 2005), prepared by Stratos.

While the level of voluntary sustainability reporting is increasing, the GRI guidelines are used principally by larger corporations. For instance, while the number of S&P 100 companies adopting the GRI guidelines increased from 25 to 34 of those 100 companies between the 2004–05 and the 2005–06 reporting period, only 66 of the S&P 500 companies issued reports in the 2005–2006 reporting period using the GRI guidelines: *Social Investment Research Analysis Network*.

The GRI Register, launched in October 2006, provides the official listings of reports using the GRI Guidelines.

companies and public sector entities have also chosen to report under these guidelines. However, the level of sustainability reporting by Australian listed companies, while increasing, may be less than the average for OECD countries.<sup>136</sup> Some reporting entities have also chosen to have their reports verified, audited or assured by

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The results on international trends still have to be considered in the broader context that less than 4% of the world's 50,000 major companies report on corporate social responsibility issues: Ernst & Young, *Risk Management Series* (5th edn, July 2005) at 3; J Bebbington & R Gray 'Corporate Sustainability: Accounting and the Pursuit of the Impossible Dream' in *Handbook of Sustainable Development* (forthcoming), as reported in the **sundayherald** (Scotland) 25 June 2006 'Study slams trivial social responsibility reports'.

<sup>136</sup> **Uptake of GRI in Australia.** KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* (June 2005) reports that the uptake of public reporting in Australia is increasing, though it is still comparatively low by international standards. It has grown from 14% of the top ASX 100 companies in 2002 to 23% of the top ASX 100 companies in 2005. Australia is ranked 11 out of the 16 countries surveyed. *The State of Sustainability Reporting in Australia 2005* (Department of the Environment and Heritage) contained results similar to the KPMG survey. It indicated that there has been a significant increase in the rate of sustainability reporting in Australia over the last decade, from 1% of the top 500 companies in 1995, to 13% in 2000 and 24% in 2005. However, on a comparison of the rate of sustainability reporting by the top 100 listed companies in 16 countries, Australia in 2005, at 23%, is significantly less than the average of 41% for these countries. That report also noted that the percentage of sustainability reports produced by Australian companies stating that the reports were 'in accordance with' or were made 'with reference to' the GRI Guidelines increased from 30% in 2004 to 51% in 2005. The report concluded that, despite the growth in sustainability reporting in 2005, Australian companies are lagging behind their overseas counterparts. 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 triple bottom line 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.

independent experts who attest that the information in the reports is accurate.<sup>137</sup>

Some Australian public sector bodies have been involved in developing methodologies to assist entities that choose to adopt the

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<sup>137</sup> **External verification.** Key verification frameworks in the international context are the *AA1000 Assurance Standard* (AA1000AS), launched in March 2003 by AccountAbility, and the *International Standard on Assurance Engagements* (ISAE 3000), launched in January 2005 by the International Auditing and Accounting Standards Board. A useful overview of each standard and how the standards interrelate is given by AccountAbility and KPMG Sustainability in *Assurance Standards Briefing: AA1000 Assurance Standard & ISAE3000* (April 2005). See also AccountAbility *Guidance Note on the Principles of Materiality, Completeness and Responsiveness as they relate to the AA1000 Assurance Standard* (2006). The AA1000AS Register, launched in October 2006, provides a complete list of reports assured using the AA1000 Assurance Standard. See also 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. Likewise, the report by Context, *Reporting in Context: Global Corporate Responsibility reporting trends 2006*, said that a majority of Europe's top 100 companies use external assurance to validate their sustainability reports. CPA Australia, in *Confidence in Corporate Reporting 2005*, reported that the overwhelming majority of respondents to a survey conducted in September 2005 agreed with the proposition that a company's social and environmental information is only worthwhile if it is subject to an independent audit. *The State of Sustainability Reporting in Australia 2005* (Department of the Environment and Heritage) indicated that, of the 119 of the top 500 companies in Australia that produced a sustainability report in 2005, 40 (34%) had their reports independently verified. This was an increase from 28% in 2004. Respondents to the survey cited financial cost as one major impediment to having sustainability reports independently verified.

GRI or similar principles<sup>138</sup> as well as preparing their own reports applying those principles.<sup>139</sup>

### *Future trends and issues*

The number of corporations, nationally and globally, that choose to adopt the GRI or other voluntary non-financial reporting guidelines will be influenced by various, sometimes competing, factors.

On the one hand, companies can use sustainability or triple bottom line reports to demonstrate to a range of stakeholders,<sup>140</sup> and capital markets generally, 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). According to one commentary:

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

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<sup>138</sup> **Public sector guidance initiatives.** A document published by the Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (June 2003), is designed to complement the GRI guidelines by ‘providing Australian organizations with tangible and easy to use methodologies for measuring performance against key environmental indicators’ (at iii). It identifies the various steps in preparing an environmental report.

See also the Department of Family and Community Services *Triple Bottom Line Reporting in Australia: A Guide to Reporting against Social Indicators*, Draft in Discussion, July 2004. A final version of this document has not been published.

<sup>139</sup> **Public sector reporting initiatives.** 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.

<sup>140</sup> **Potential audience for sustainability reports.** The report commissioned by the Department of the Environment and Heritage, *The State of Sustainability Reporting in Australia 2005*, stated (at 31) that the target audiences for sustainability reports that it had surveyed included employees, shareholders, customers, local communities, institutional investors, suppliers and analysts.

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.<sup>141</sup>

These reports can also help companies to attract equity or loan capital by assisting investors and financiers to assess and value their non-financial parameters and otherwise enhance their corporate reputation and advance their competitive position.<sup>142</sup>

On the other hand, problems that sustainability or triple bottom line reports may raise for stakeholders, as well as companies, include possible information overload, the sometimes 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.<sup>143</sup> These problems may be accentuated for multinational

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<sup>141</sup> **Source.** Group of 100, *Sustainability: A Guide to Triple Bottom Line Reporting* (June 2003) at 16.

<sup>142</sup> **Benefits of sustainability reports.** *The State of Sustainability Reporting in Australia 2005* (Department of the Environment and Heritage), having 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, including improved management of corporate risks, gaining the confidence of investors, insurers and financial institutions and recruiting and retaining high quality staff.

Some uncertainty remains about how well sustainability and other forms of corporate social responsibility reports are meeting the expectation of financial markets. For instance, a report by 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. By comparison, the SustainAbility report *Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting* (November 2006) observed (at p 2) that:

Cutting-edge sustainability reports are framed as a key component of—and platform for—a portfolio of information available to both socially responsible investment (SRI) funds and, increasingly, to mainstream investors

and that

Some parts of the financial community are gearing up their use of non-financial, extra-financial and/or sustainability disclosures to better understand emerging [corporate] environmental, social and governance risks.

<sup>143</sup> **Some problems with sustainability reports.** The CPA Australia research document *Sustainability Reporting: Practices, Performance and Potential* (July 2005) commented (at 19) 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.

corporations, which may also face an array of specific disclosure and reporting requirements in various jurisdictions.

Companies, including smaller enterprises, may be particularly concerned about the start-up costs of sustainability or triple bottom line reporting, and whether there are discernible benefits for these outlays.<sup>144</sup> Also, these reports, even though voluntary, could attract liability for any misstatements.<sup>145</sup> Companies also need to consider whether to have their reports independently verified or audited, to improve their credibility and overcome possible perceptions of ‘greenwashing’ through selective positive-only reporting.<sup>146</sup>

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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.

<sup>144</sup> **Costs of sustainability reports.** *The State of Sustainability Reporting in Australia 2005* (Department of the Environment and Heritage) indicated (at 42) that the principal perceived impediment to undertaking sustainability reporting was cost, particularly related to developing an initial framework for measuring and reporting, as well as the cost of undertaking external verification, including the availability of indicators:

For the last three years [2003–2005] companies have been consistent in their identification of cost and resource constraints as the key impediment to sustainability reporting.

Another 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 financial outlays.

<sup>145</sup> **Legal liability.** The Australian law is summarised in Section 4.3. An overseas precedent is *Kaski v Nike* 2003 (Californian 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, in which Nike agreed to pay \$US1.5 million in damages, 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).

<sup>146</sup> **Independent assurance.** The GRI Sustainability Reporting Guidelines recommend the use of independent external assurance for sustainability reports.

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 (at 1) that:

Another issue concerns the appropriate balance between mandatory and voluntary sustainability reporting in particular jurisdictions, taking into account that many jurisdictions already have reporting requirements that include some form of environmental and social disclosure (as explained in Chapter 4).

Proponents of greater mandatory reporting argue that insufficient companies may be adopting voluntary reporting standards and that introducing further mandatory requirements can add to the credibility of reports and help ensure a minimum consistent and comparable level of disclosure. A contrary view is that voluntary reporting is still evolving and innovations in the form and content of these reports may be impeded through further legislative prescription, which also may be out of step with reporting developments elsewhere.<sup>147</sup>

## 2.5 Advisory Committee view

The social responsibility of corporations should be considered in the context of their overall economic and other contributions to society, as well as any negative impacts. These contributions include the supply of goods and services, the generation of wealth for shareholders, the payment of taxes and the provision of employment, all of which go to strengthening the economy and improving community living standards. On the other hand, negative aspects of corporate business operations and the way they are conducted,

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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.

The CPA Australia report *Confidence in Corporate Reporting 2005* indicated that a majority of respondents to a survey conducted in September 2005 considered that social and environmental reporting was often mainly a public relations exercise. Most respondents also agreed with the proposition that a company's social and environmental information is only worthwhile if it is subject to an independent audit.

<sup>147</sup> **Balance of voluntary and mandatory reporting.** The issues involved in debate on the balance between voluntary and mandatory sustainability reporting are reviewed in the UNEP and KPMG Global Sustainability Services report *Carrots and sticks for starters: current trends and approaches in voluntary and mandatory standards for sustainability reporting* (October 2006), in particular Section 3, which sets out the advantages and disadvantages of voluntary standards and self-regulation, and mandatory standards, respectively.

whether in relation to creditors, employees, local communities, the environment or otherwise, need to be taken into account.

Companies should also be judged in terms of their compliance with applicable laws, including environmental and other statutes designed to promote or protect aspects of the public interest. How far their business practices and internal standards are designed to promote compliance with the 'spirit' as well as the 'letter' of the law, or other emerging community expectations, may also be taken into account.

Beyond that, a well-managed company will generally see it as being in its own commercial interests, in terms of enhancing corporate value or opportunity, or managing risks to its business, to assess and, where appropriate, respond to the impact of its activities on the environmental and social context in which it operates. Companies that fail to do so appropriately may jeopardise their commercial future.

The Committee sees merit in the approach in the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006) of treating social and environmental matters in the context of 'material business risks'.

The 'business' approach does not involve inappropriate compromise or subordination by directors of the interests of shareholders to those of other interest groups. Rather, awareness of relevant environmental and social considerations is part of any strategy to promote the continuing well-being of the company and to maximise shareholder value over the longer term. The relevance of particular social or environmental matters will vary, depending on the nature of a company's business.

Consistent with the business approach, directors may sometimes choose to go further, where they see it as relevant to their business interests, in promoting particular societal values or goals or in seeking solutions to challenges facing their industry and the community. But this is not to suggest that companies bear some form of obligation to tackle wider problems facing society, regardless of the relevance of those problems to their own business.

The Advisory Committee considers that the business approach provides an appropriate framework within which companies can respond to issues of social responsibility:

- directors have adequate flexibility under current law to act in a socially responsible manner. While able to have regard to other interests, they should remain accountable to shareholders; any extension of accountability to other stakeholders would undermine effective corporate governance. These matters are further considered in Chapter 3
- disclosure of information about relevant corporate activities supports effective accountability. There is scope for the reporting by companies of non-financial information to evolve within the framework of the Corporations Act, with the development of reporting forms and practices being assisted by various market initiatives, as explained in Chapter 4
- government can encourage responsibility by laying down appropriate boundaries for corporate behaviour by legislation, by upholding the accountability governance framework for companies and by regulatory action to encourage compliance and enforce the law. There are other 'light touch' steps that can be taken to facilitate or encourage companies in carrying out the business approach to corporate responsibility, as discussed in Chapter 5.



## 3 Duties of directors

*Part A of 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 indicates 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.*

*Part B of this chapter considers whether the Corporations Act should be amended expressly to permit, or require, directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. For this purpose, the chapter outlines the ‘pluralist’ approach, adopted in various states of the USA, and an ‘elaborated shareholder benefit’ approach in the United Kingdom, summarises the views and proposals in submissions and sets out the Advisory Committee’s conclusions.*

### Part A. Current position

#### 3.1 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 formal terms, the power to manage is delegated by the shareholders to the directors.<sup>148</sup> However, this delegation is subject to certain matters that are reserved for decision by the shareholders as a whole under the

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<sup>148</sup> **Legal relationship between directors and shareholders.** This analysis of the relationship between shareholders and directors is often referred to as the ‘principal-agent’ model of the corporation.

Corporations Act and the ASX Listing Rules<sup>149</sup> 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 granted in the corporate constitution and by legislation.<sup>150</sup> In exercising these powers, the board is not subject to shareholder direction,<sup>151</sup> and retains a considerable discretion in its corporate decision-making, provided it acts lawfully (as explained in this chapter). In large companies in particular, it is also common for directors to delegate day-to-day decision-making to senior managers, who are responsible for running the company under the direction and supervision of the board.

The principal method for shareholders to make corporate decisions on the limited range of matters reserved to them is through resolutions at company general meetings. Shareholders can use this mechanism to seek to have the company adopt various

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<sup>149</sup> **Powers of shareholders.** 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](http://www.camac.gov.au)).

<sup>150</sup> **Powers of the board determined by corporate constitution.** At common law, the division of powers between the board and the company in general meeting is determined by the corporate 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)).

<sup>151</sup> **Board autonomy on matters vested in it.** The general principle, as set out in *NRMA v Parker* (1986) 4 ACLC 609 at 614, is that:

It is no part of the function of the members of a company in general meeting by resolution, ie as a formal act of the company, to express an opinion as to how a power vested by the constitution of the company in some other body or person ought to be exercised by that other body or person.

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 ...

environmental or social policies or goals.<sup>152</sup> For instance, they may propose resolutions to include a ‘social responsibility’ charter in the company’s constitution requiring the board to take into account various environmental or social factors or goals, or the interests of various stakeholders, not just shareholders.<sup>153</sup> Directors have a duty to act in accordance with a company’s constitution.

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<sup>152</sup> **Shareholders proposing resolutions at general meetings.** 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.

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

K Anderson & I Ramsay, in ‘From the picket line to the board room: Union shareholder activism in Australia’ (2006) *Company and Securities Law Journal* 279, examine the relevant statutory provisions and case law concerning shareholders putting forward resolutions at annual general meetings, calling extraordinary general meetings, using proxies, and posing questions at general meetings, in the context of various case studies on how trade unions, as shareholders, have employed these means to pursue employee interests.

<sup>153</sup> **Social responsibility charter in corporate constitution.** A charter could be seen as reducing board decision-making autonomy. However, 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.

An alteration to a constitution requires a special resolution (s 136(2)).

Some overseas companies have included in their constitutions a prohibition on accepting goods from companies engaging in unethical practices: B Eyre ‘The crusade for corporate social responsibility’ *European Lawyer* Issue 42, October 2004.

### 3.2 Common law fiduciary duties

Directors, and other individuals involved in companies, are subject to common law, as well as statutory, duties and liabilities.<sup>154</sup>

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.<sup>155</sup> 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.<sup>156</sup>

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.<sup>157</sup> Equally, however, there is no case law that

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<sup>154</sup> **Common law and statutory duties apply.** Subsection 179(1) and s 185 of the Corporations Act make clear that the statutory duties in the Act do not exclude the operation of other laws, including the general law.

<sup>155</sup> **Company means shareholders collectively.** See *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.

<sup>156</sup> **Interests of creditors.** 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.

<sup>157</sup> **Directors may consider longer-term factors.** 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. However, it is doubtful whether this constitutes an obligation to consider future shareholders: see RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.8.

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 the 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).

directors who act in the short-term interests of present members have breached their duty. Rather, it is a matter for companies themselves and the commercial judgment of directors how to balance or prioritise shorter-term and longer-term considerations.<sup>158</sup> These principles apply equally to the statutory fiduciary duties, discussed at Section 3.3.

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 reduce corporate wealth in the short term by granting bonuses to current employees on the reasoning that this may benefit the company, immediately or in the future, in terms of increased morale and loyalty.<sup>159</sup> 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 distributions are not reasonably incidental to the ongoing business of the company or otherwise beneficial to it.<sup>160</sup>

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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.

A Lumsden & S Fridman, in 'Corporate Social Responsibility: the case for a self regulatory model' *Company and Securities Law Journal* (forthcoming), observe that fulfilling the purpose of a corporation to deliver shareholder value is a long-term continuing activity:

The profits [companies] declare this quarter often come from investments made many years ago and future profits will depend upon the investments made today.

Also:

Clearly, then, there is considerable support for the idea that managers do not need to prefer the short-term interests of present shareholders. If that were the case then every dollar available for dividend should be paid out and there would be no justification in attempting to reinvest funds or expand the corporation's market by price-cutting.

<sup>158</sup> **Short-termism.** There are various initiatives open to companies to counter any undue emphasis on short-term performance, including aligning executive remuneration with longer-term corporate objectives and strategies, and improving communication to investors, market analysts and shareholders about these objectives and strategies. See also footnote 112.

<sup>159</sup> **Permitted benefits.** *Hampson v Price's Patent Candle Co* (1876) 45 LT Eq 437.

<sup>160</sup> **Principles for disposal of corporate funds.** 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:

The case law does not rule out all ex gratia payments. In the leading case of *Parke v Daily News* [1962] 1 Ch 927, it was held 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.<sup>161</sup>

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.

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

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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.

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.

<sup>161</sup> **Principles in *Parke v Daily News*.** A useful analysis of each of the tests in *Parke v Daily News* 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.

and not for irrelevant purposes, is not open to review in the courts.<sup>162</sup>

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.

Subsequently, in *People's Department Stores Inc v Wise* (2004) 244 DLR (4<sup>th</sup>) 564 at [42], 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.

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<sup>162</sup> **Judicial policy of non-interference.** 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:

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.

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 mean that directors must not consider other interests. The 'interests of the company' include the continuing well-being of the company. Directors may 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.<sup>163</sup>

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 proprietors.<sup>164</sup>

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<sup>163</sup> **Source.** Section 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.

<sup>164</sup> **Source.** Unpublished paper by RI Barrett (1999).

Stated another way:

if the altruistic purpose being considered by management cannot be couched in terms of what's good for the corporation, then management will have acted improperly.<sup>165</sup>

Other commentators take a similar view and also identify various constraints on directors in undertaking philanthropic activities.<sup>166</sup>

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<sup>165</sup> **Source.** A Lumsden & S Fridman, 'Corporate Social Responsibility: the case for a self regulatory model' *Company and Securities Law Journal* (forthcoming).

<sup>166</sup> **Constraints on corporate philanthropy.** 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 constraints under Australian law on directors in undertaking philanthropic activities, 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 corporate 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.

### 3.3 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 relevant to issues of corporate social responsibility are ss 180 and 181 of the Corporations Act.

#### 3.3.1 Section 180

##### *The duty*

Subsection 180(1) 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) imposes an objective standard of care and diligence, intended to reflect contemporary community expectations.<sup>167</sup> 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.<sup>168</sup> In applying that test, the foreseeable risk of harm must be balanced against the potential benefits that could reasonably accrue to the company from the conduct.<sup>169</sup> 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.<sup>170</sup>

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<sup>167</sup> **Objective test.** *ASIC v Rich* (2003) 44 ACSR 341 at [71], *Deputy Commissioner of Taxation v Clark* (2003) 45 ACSR 332 at [108]–[109], *ASIC v Vines* (2005) 55 ACSR 617 at [1058]–[1060].

<sup>168</sup> **Reasonable foreseeability test.** In *ASIC v Vines* (2005) 55 ACSR 617 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.

<sup>169</sup> **Balancing test.** *Vrisakis v ASC* (1993) 11 ACSR 162 at 211–213; *ASIC v Doyle* (2001) 38 ACSR 606 at 641, para [222].

<sup>170</sup> **Breach if no possible benefit.** *Gamble v Hoffman* (1997) 24 ACSR 369, *ASIC v Adler* (2002) 41 ACSR 72.

### *Business judgment 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 that the judgment was in the best interests of the corporation (s 180(2)). The defence provides that '[a] 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'.

### **3.3.2 Section 181**

#### *The duties*

Section 181 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'.<sup>171</sup> 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.<sup>172</sup>

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 company<sup>173</sup>
- although there may be no direct legal obligation in company law on directors to take the interests of stakeholders other than

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<sup>171</sup> **History of s 181.** 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](http://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'.

<sup>172</sup> **Applying the objective test in s 181.** *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].

<sup>173</sup> **Source.** RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.2.

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 is no prospect of commercial advantage to the company.<sup>174</sup>

### *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 ‘if no reasonable board could consider a decision to be within the interests of the company’.<sup>175</sup>

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.<sup>176</sup>

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.

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<sup>174</sup> **Source.** id at 7.13.

<sup>175</sup> **Subjective test not sufficient.** *ASIC v Adler* (2002) 41 ACSR 72 at [739]. 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.

<sup>176</sup> **Meaning of proper purpose.** RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.19–7.22. Another useful summary of actions that have been 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.

## 3.4 Enforcement of statutory fiduciary duties

### 3.4.1 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<sup>177</sup> compensation orders<sup>178</sup> and disqualification from managing a corporation.<sup>179</sup> 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.<sup>180</sup> It is doubtful whether shareholders can ratify, and thereby excuse, a breach of the statutory fiduciary duties.<sup>181</sup>

### 3.4.2 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 the Australian Securities and Investments Commission (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 conduct<sup>182</sup> or order the person in breach to pay damages.<sup>183</sup>

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<sup>177</sup> **Pecuniary penalties.** Section 1317G provides that a court may order a person to pay the Commonwealth a pecuniary penalty of up to \$200,000 in various circumstances.

<sup>178</sup> **Compensation.** s 1317H.

<sup>179</sup> **Disqualification from management.** s 206C.

<sup>180</sup> **Automatic disqualification from management.** s 206B.

<sup>181</sup> **Shareholders cannot ratify breach.** The NSW Court of Appeal in *Forge v ASIC* (2004) 52 ACSR 1 at [378]-[382] held that shareholders could not lawfully ratify a breach of a statutory civil penalty provision. The same view was taken by Gleeson CJ and Heydon J in *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 53 ACSR 208 at [24] and [32], though a contrary view was expressed by Gummow and Hayne JJ at [67], at least for solvent companies.

<sup>182</sup> **Injunction power.** s 1324(1), (4).

<sup>183</sup> **Power to award damages.** s 1324(10).

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.<sup>184</sup>

### 3.4.3 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 a director, including for breach of the fiduciary duties under ss 180 and 181.<sup>185</sup>

### 3.4.4 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.<sup>186</sup>

## 3.5 ASX requirements

Listed companies are also subject to the rule of the Australian Stock Exchange. The ASX Corporate Governance Council, in its *Principles of Good Corporate Governance and Best Practice*

<sup>184</sup> **Standing to seek a remedy.** *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 suggested (at 613) 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.

<sup>185</sup> **Shareholder derivative actions.** ss 236, 237.

<sup>186</sup> **Oppression.** 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].

*Recommendations*, 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. Draft Principle 3 (November 2006) (which is an elaboration on, and is intended to replace, part of Principle 10) states, in part, that:

To be successful, companies need to have regard to their legal obligations and the interests of a range of stakeholders including shareholders, employees, business partners, creditors, consumers, the environment and the broader community in which they operate. It is important for companies to demonstrate their commitment to appropriate corporate practices and decision making.

### 3.6 Compliance with public laws

Companies are subject to a range of Commonwealth, 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, competition, consumer protection, human rights (such as anti-discrimination) and anti-corruption statutes.<sup>187</sup>

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.<sup>188</sup> Rather:

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<sup>187</sup> **Environmental and social legislation.** Relevant Commonwealth, State and Territory environmental, occupational health and safety, hazardous goods and consumer protection legislation is referred to in the Advisory Committee report *Personal liability for corporate fault* (September 2006) (available at [www.camac.gov.au](http://www.camac.gov.au)).

Relevant Commonwealth anti-discrimination legislation includes the *Age Discrimination Act 2004*, the *Disability Discrimination Act 1992*, the *Racial Discrimination Act 1975*, and the *Sex Discrimination Act 1984*.

Australian companies and their officers are subject to Division 70 of the Commonwealth *Criminal Code* (Bribery of foreign public officials). A useful summary of Australian anti-bribery laws and a comparison with comparable UK and US laws are included in the Centre for Australian Ethical Research report, “*Just how business is done?*” *A review of Australian business’ approach to Bribery and Corruption* (March 2006).

<sup>188</sup> **Obligation to comply.** B Horrigan, in ‘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:

- 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 company.<sup>189</sup> They may also be personally liable in consequence of offences committed by their companies under these laws<sup>190</sup>
- 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.<sup>191</sup>

## Part B. Matters for consideration

### 3.7 Alternatives to the current law

As seen from the analysis in Part A, 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.

The terms of reference raise for consideration whether any change in the present position is required or would be worthwhile:

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

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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.

<sup>189</sup> **Breach by directors.** 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.

<sup>190</sup> **Personal liability of directors.** See further the Advisory Committee Report *Personal liability for corporate fault* (September 2006) (available at [www.camac.gov.au](http://www.camac.gov.au)).

<sup>191</sup> **Adverse financial effects not an excuse.** 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.

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?

These questions have been considered in general terms from time to time, primarily in the context of two diverging approaches:

- *a pluralist approach*, under which certain other interest groups would, or may, 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.

## 3.8 Pluralist approach

### 3.8.1 Overview

A pluralist approach 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 as 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, which 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 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 along pluralist lines.

### 3.8.2 Views of Senate Committee in 1989

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 move to legislate for a pluralist approach to directors' duties.

#### *Mandatory pluralism*

The 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 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.<sup>192</sup>

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

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<sup>192</sup> **Source.** para 6.51.

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 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.<sup>193</sup>

### *Permissive pluralism*

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.<sup>194</sup>

### *Specific legislation*

The Senate report recommended that, rather than introduce a mandatory or permissive provision into the corporations legislation, matters such as the interests of consumers or environmental protection be dealt with in legislation aimed specifically at those matters.<sup>195</sup>

## **3.8.3 US corporate constituency statutes**

Statutes in a number of US states expressly permit directors to take into account the interests of various non-shareholder groups or

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<sup>193</sup> **Source.** paras 6.45–6.47.

<sup>194</sup> **Source.** para 6.44.

<sup>195</sup> **Source.** para 6.56.

broader community considerations in their decision-making. These 'corporate constituency' provisions, first introduced in the 1980s, are found in a majority of states (though not including Delaware, where many large US companies are incorporated). They were primarily intended to assist directors to defend against hostile takeover bids that were seen as detrimental to various non-shareholder groups, including employees, or to local state communities.

The corporate constituency statutes typically adopt a permissive pluralism approach by allowing, but not requiring, corporate decision-makers to consider the broader constituency. Approximately half the statutes are confined to takeover or other change of control situations, while the remaining statutes are not so limited.<sup>196</sup>

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 the broader considerations in response to a claim that they had breached their fiduciary duties by placing the interests of other parties above those of shareholders.

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

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

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<sup>196</sup> **Corporate constituency statutes.** For a useful summary of the US state statutes, see K Hale, 'Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823.

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.

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 give closer attention to the overall impact of corporate action, but without diminishing shareholder interests, given the voting power of shareholders.<sup>197</sup>

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.<sup>198</sup>

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

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

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<sup>197</sup> **Corporate constituency statutes and shareholder interests.** See, for instance, L Mitchell, 'A theoretical and practical framework for enforcing corporate constituency statutes' (1991) 70 *Texas Law Review* 579.

<sup>198</sup> **Source.** ABA Committee on Corporate Laws, 'Other Constituencies Statutes: Potential for Confusion' (1990) 45 *Business Law* 2253 at 2269.

... 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 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.<sup>199</sup>

Other critics of these statutes have argued that they could convert directors into 'unelected civil servants' with a responsibility for determining the public interest.<sup>200</sup>

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 early years 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.<sup>201</sup>

### 3.9 Elaborated shareholder benefit approach

#### 3.9.1 Overview

This approach differs from the pluralist approach in requiring directors, as under current Australian law, to act for the benefit of the shareholders of the company as a whole. It goes further than the current law by expressly referring to various considerations that

<sup>199</sup> **Source.** id at 2269 ff.

<sup>200</sup> **Criticism of corporate constituency statutes.** 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.

<sup>201</sup> **Use of corporate constituency statutes.** 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.

directors may, or should, take into account in determining what is for the benefit of shareholders generally.

The approach is exemplified by s 172 of the UK *Companies Act 2006*. This section derived 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 compared the differences between the pluralist approach and its approach, which it described as ‘enlightened shareholder value’ 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 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).<sup>202</sup>

### 3.9.2 UK Companies Act 2006

Section 172 of the *Companies Act 2006* 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 section 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. As summed up by a member of the Steering Group:

the purpose of the company is to create value for the benefit of shareholders, but this should be done by taking a long-term view of the company where possible and thus the

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<sup>202</sup> **Source.** *Modern Company Law for a Competitive Environment: The Strategic Framework* (1999) para 5.1.15.

relationships which the company has with suppliers, employees, the community and so on have to be fostered

and:

directors' duties will remain owed to the company and thus be enforceable only by the company or by an action on its behalf—for instance, a members'/shareholders' action—but not be enforceable by the employees or suppliers or creditors.<sup>203</sup>

Section 172 provides as follows:

*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, and in so doing have regard (amongst other matters) 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.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

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<sup>203</sup> **Source.** Paper by the Rt Hon Lady Justice MH Arden in *Company directors and corporate social responsibility: UK and Australian perspectives*, *Proceedings of a Conference organised by the Supreme Court of New South Wales and the Law Society of New South Wales, August 2006*, Parsons Foundation, forthcoming.

(3) 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.

According to another member of the Steering Group:

- s 172(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
- s 172(1)(a) is consistent with the common law, which has never required short-termism
- s 172(1)(b)-(e) seek 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.<sup>204</sup>

A member of the Steering Group has commented that, in relation to s 172(1)(a):

the view was taken that it was better that companies looked to the long-term because that is more likely to create employment than asset stripping; it is more likely to lead to a company’s operations being conducted in a manner which is a sustainable manner and in a manner which takes into account the interests of the community

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<sup>204</sup> **Source.** Professor P Davies, ‘Enlightened Shareholder Value and the New Responsibilities of Directors’, WE Hearn Lecture at the University of Melbourne Law School, 4 October 2005.

and that s 172(2) applies only to community interest companies:

it was not intended to apply to any company other than what we call an altruistic company—the one where the members cannot take any profits.<sup>205</sup>

Some questions that could be raised about the clause include:

- whether the phrase ‘he [a director] ... considers’ in s 172(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 s 172(1) that a director must ‘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
- whether any consequences follow from the specific reference in s 172(1)(b) and (c) to some, but not necessarily all, possible stakeholder groups.

The UK provision has been discussed in some detail in Australia. On one view, adopting the directors’ duties provision in the UK Act in the Corporations Act may be unnecessary if it is designed merely to codify the current common law, as reflected in s 181 of the Corporations Act. Alternatively, this provision could result in a radical change from traditional company law, if interpreted in the Australian context as some form of general departure from the current obligation of directors in s 181 to act in the best interests of the shareholders generally. Arguably, it could also entrench in legislation particular stakeholder and other criteria that, while

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<sup>205</sup> **Source.** Paper by the Rt Hon Lady Justice MH Arden, and response to questions in Session 1, in *Company directors and corporate social responsibility: UK and Australian perspectives*, *Proceedings of a Conference organised by the Supreme Court of New South Wales and the Law Society of New South Wales, August 2006*, Parsons Foundation, forthcoming.

possibly reflecting current concerns, may not necessarily be appropriate for corporate decision-making in the future.<sup>206</sup>

### 3.10 PJC Report

The Parliamentary Joint Committee on Corporations and Financial Services recommended against any amendment to the directors' duties provisions in the Corporations Act, though investors, stakeholders and relevant business associations should encourage companies to include long-term and corporate responsibility performance measures as part of the remuneration package of company directors, executive officers and managers.<sup>207</sup>

### 3.11 Views in submissions

The Advisory Committee received a range of views in submissions on the adequacy of the current law of directors' duties in regard to the place of social and environmental considerations in corporate decision-making. The submissions on this topic are summarised below, with a more detailed version of that summary set out in *Summary of submissions*, available at [www.camac.gov.au](http://www.camac.gov.au)

#### 3.11.1 Current law

The submissions generally agreed with the proposition, as explained in Part A of this chapter, that under common law and the relevant statutory provisions, in particular s 181 of the Corporations Act, directors, in acting in good faith, in the best interests of the company and for a proper purpose, may take into account a range of factors external to the shareholders if this benefits the shareholders as a whole.

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<sup>206</sup> **Discussion of UK provision in Australia.** See, for instance, the various views expressed by participants in *Company directors and corporate social responsibility: UK and Australian perspectives*, *Proceedings of a Conference organised by the Supreme Court of New South Wales and the Law Society of New South Wales, August 2006*, Parsons Foundation, forthcoming.

<sup>207</sup> **PJC report.** *Corporate responsibility: managing risk and creating value* (June 2006). Relevant recommendations of the majority are at Recommendations 1 and 14. The Labor members of the PJC, in their supplementary report, considered that, if legal barriers to the consideration of legitimate environmental and social issues by directors arise, the matter should be reconsidered (Recommendation 4 of the supplementary report).

Views differed, however, on whether this was adequate or whether some legislative amendment to directors' duties was useful or necessary.

### **3.11.2 The business approach**

Various respondents argued that no legislative clarification or other amendment to directors' duties was necessary as:

- companies are already subject to a range of Federal, State and Territory laws that are designed to protect various stakeholder groups or public values, including occupational health and safety, discrimination and equal opportunity in employment and the provision of goods and services, environmental impact and anti-corruption laws. Each of these laws articulates minimum standards of conduct and enshrines certain rights in clear and accessible terms, with civil, and sometimes criminal, penalties associated with failure to adhere to the requisite standards
- directors cannot lawfully 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 would reduce shareholder returns
- over and above these obligations it is likely to be in a company's own interests, at least over the longer term, to take into account the environmental and social context in which it operates (in terms of value enhancement and risk management, including reputational risk and regulatory risk), not just focus on immediate returns to shareholders
- subject to directors acting in the best interests of the company, and the company complying with all applicable laws, it should be a matter for the commercial judgment of directors, not legislative prescription, what stakeholder interests to consider in particular situations and how to manage, balance or prioritise them.

### 3.11.3 Critique of the business approach

Some respondents were concerned about the right of directors under current law to choose what, if any, stakeholder interests to take into account in their decision-making. They noted that directors have no obligation under existing law to consider and give effect to non-shareholder interests for their own sake. Respondents used this observation as a starting point for proposing a more prescriptive legislative regime for directors' duties. There was also some comment in submissions on the legal issues that faced the board of James Hardie Industries Ltd in relation to the asbestos-related liabilities of subsidiary companies.

### 3.11.4 Proposals for legislative change

A number of respondents put forward proposals to amend the duties of directors in the Corporations Act or introduce other changes related to those duties. Those proposals included, but also extended beyond, the pluralist and elaborated shareholder benefit approaches.

Some of the proposals sought to increase the range of groups or interests that directors should be obliged to consider in their decision-making, while others sought to give directors greater discretion to consider these interests.

The proposals included:

- *permissive pluralism* in the form of a provision (possibly an amendment to s 181 of the Corporations Act) that would expressly permit directors to take into account the interests of specific classes of stakeholders, extending beyond shareholders, or the broader community, in corporate decision-making
- *an amended business judgment defence* either to liberalise the defence to give greater protection to directors and officers who choose to take various stakeholder interests into account or, conversely, to impose additional prerequisites on directors and officers to take stakeholder interests into account before they can avail themselves of the defence
- *inclusion of subjective elements in s 181* so that the test is whether the directors are acting in good faith in what they believe to be in the interests of the corporation

- *a replaceable rule* permitting directors to take account of the interests of stakeholders other than shareholders
- *mandatory pluralism* whereby directors would expressly be obliged to take into account the interests of specific classes of stakeholders, extending beyond shareholders, or the broader community, in corporate decision-making
- *adoption of the UK Companies Act approach* which sets out various environmental and social criteria and stakeholder groups to which directors must have regard in promoting the success of the company
- *an ethical judgment rule* designed to afford directors some protection from liability in the event that their ethical decision causes a detrimental impact on the financial interests of the company as a whole
- *responding to short-termism* either to place greater obligations on directors to take long-term matters into account or, conversely, to give greater protection to directors who choose long-term over short-term considerations in corporate decision-making
- *a 'licence to operate' approach* to require directors and officers to consider 'legitimate stakeholder expectations' as an additional requirement for making proper business judgments
- *a statutory elaboration of the decision-making framework* in the form of a range of factors that directors and others should be entitled to take into account in corporate decision-making
- *a provision for employee representation on the board* following the German model
- *mandatory stakeholder advisory boards* representing the various constituencies of the corporation, to inform the directors on business operations and other matters of concern such as social and environmental issues.

### 3.12 Advisory Committee view

The Committee acknowledges the concern in many submissions about the need for companies to consider the environmental and social impact of their conduct. The question is how best to respond to those concerns.

As noted in various submissions, the environmental and social matters referred to in the debate on corporate social responsibility are really factors that directors should already be taking into account in determining what is in the best interests of their corporation in its particular circumstances. Also, a company may choose (by resolution of shareholders) to hold itself to a particular approach to the conduct of its business by adopting some form of 'social responsibility' charter in its constitution.

The Committee considers that the current common law and statutory requirements on directors and others to act in the interests of their companies, as explained in Part A of this chapter, are sufficiently broad to enable corporate decision-makers to take into account the environmental and other social impacts of their decisions, including changes in societal expectations about the role of companies and how they should conduct their affairs. The Committee is not persuaded that the elaboration of interests that, where relevant, can already be taken into account would improve the quality of corporate decision-making in any practical way. A non-exhaustive catalogue of interests to be taken into account serves little useful purpose for directors and affords them no guidance on how various interests are to be weighed, prioritised or reconciled.

Also, the courts, through their interpretation of the law, including the requirement in s 181 of the Corporations Act for directors and others to act in the 'best interests of the company', can assist in aligning corporate behaviour with changing community expectations. Given this, it is unnecessary to amend that section along the lines of s 172 of the UK *Companies Act 2006* and no worthwhile benefit is to be gained.

The Committee considers that an amendment to the Corporations Act, either specifically to require or to permit directors to have regard to certain matters or the interests of certain classes of stakeholders, could in fact be counterproductive. There is a real danger that such a provision would blur rather than clarify the

purpose that directors are expected to serve. In so doing, it could make directors less accountable to shareholders without significantly enhancing the rights of other parties.

The Committee agrees with the observations to similar effect in the 1989 Senate Report (Section 3.8.2, above) and in many of the submissions. The Australian Securities and Investments Commission pointed out in its submission:

Depending on its precise nature and drafting, such an amendment may create significant uncertainty. For example, it may be difficult for directors, ASIC and the Courts to:

- identify and define the various classes of stakeholders that might be considered to have a legitimate claim on the attention and resources of corporations; or
- establish an appropriate hierarchy of stakeholders' interests to resolve conflicting stakeholder claims on the attention and resources of corporations.

ASIC further observed that:

Such uncertainty would impact on ASIC's ability to enforce the law; the more uncertainty that exists as to the precise nature of a duty and to whom it is owed, the harder it is to prove that the duty has been breached. Where a duty is owed to a number of stakeholders with varying interests, it may be difficult for ASIC to establish that a given action was a breach of the duty, rather than the exercise of a judgment based on perceived merits of competing stakeholder interests.

The Committee has the same reservations about the 'ethical judgment' rule proposed in submissions. There is a danger that directors could rely on such a rule to reduce accountability to shareholders or use it as a shield for poor business judgments.

The Committee acknowledges concerns expressed in some submissions about the possible undue focus of some companies on short-term performance and immediate returns to shareholders, to the neglect of longer-term planning and development, including in relation to the environmental and social impact of their operations. However, investors may differ as to the relative importance they place on the value of their investments over the shorter and longer term. The law, as described in Part A of this chapter, gives directors

and other managers considerable room for judgment in their assessment of what is called for in the interests of the company. They may legitimately choose longer-term over shorter-term considerations in particular situations. Directors therefore have it within their power to chart the course for the company and face the challenge, not always easy, of communicating that course and gaining market support for it. The Committee does not see this as an issue that can usefully or appropriately be resolved by legislation.

How particular companies balance, or prioritise, short-term and longer-term considerations calls for commercial judgment. Practical measures that companies may adopt to achieve a suitable balance for their circumstances include tailoring executive remuneration to shorter-term or longer-term corporate objectives and strategies and communicating with shareholders and the market generally about these objectives and strategies.

Finally, the Advisory Committee considers that there is limited utility in looking to the Corporations Act or directors' duties to redress concerns that may arise from time to time about the environmental or social consequences of what may be perceived as irresponsible business activities. The more appropriate response where the level of concern calls for legislative intervention is to address particular behaviours or activities through legislation targeted at the mischief in question. Importantly, legislation of that kind can also cover all relevant activities whether carried out by companies, other entities or individuals and not just the corporate sector.



## 4 Corporate disclosure

*This chapter considers whether certain types of companies should be required to report on the environmental and social impact of their activities, in narrative or quantified form. It outlines current reporting requirements, refers to developments in other countries, summarises the views and proposals in submissions and sets out the Advisory Committee's conclusions.*

### 4.1 Reporting and social responsibility

With the growth of interest in the environmental, social and other impacts of corporate activities have come demands for disclosure of more and better information by companies. This has led to some changes in reporting requirements and initiatives by some companies and groups to develop better reporting practices in this area.

Questions asked of the Advisory Committee by the terms of reference include:

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

Reporting by companies on the environmental and social impact of their activities may contribute to a better-informed market and benefit interest groups and the broader community in various ways. The provision of relevant information could:

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

Enhanced reporting by companies may also:

- engender greater managerial attention to the broader impact of corporate activities as a consequence of collecting relevant information
- encourage them to undertake effective management of relevant risks
- 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.<sup>208</sup>

### 4.3 Summary of current position

While companies are subject to a range of reporting requirements, there is no provision in the Corporations Act or under the ASX listing rules that specifically refers to reporting on the social and environmental impact of corporate activities.

However, companies may, and many do, choose to report voluntarily on these matters in the context of various reports or in stand-alone 'social responsibility' or like reports (outlined in Section 4.4). There is a global trend, reflected in Australia, for larger enterprises in particular to undertake more voluntary reporting of this kind (outlined in Section 2.4.3).

In addition, there are various Corporations Act requirements (outlined in Sections 4.5 and 4.6.1) that, in effect, require the disclosure of some non-financial information. Furthermore, various ASX requirements and Corporate Governance Council principles

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<sup>208</sup> **Source.** Gunningham & Prest, 'Environmental audit as a regulatory strategy: prospects and reform' (1993) 15 *Sydney Law Review* 493.

(outlined in Section 4.6.2) call for or encourage reporting on non-financial matters.

Companies are sometimes required to make disclosures of non-financial information under other legislation. The National Pollutant Inventory<sup>209</sup> requires operators of industrial facilities to submit annual reports quantifying their emissions of certain land, water and air pollutants. Those reports are collated and made publicly available.<sup>210</sup> Likewise, the *Energy Efficiency Opportunities Act 2006* requires large energy-using private and public sector corporations to undertake assessments of their energy use and report publicly on the outcomes and their business responses.<sup>211</sup>

It should be noted that information provided by companies on social and environmental aspects of their business, whether provided voluntarily or pursuant to ASX rules or in the context of annual or other reports called for by legislation, is potentially subject to sanctions if false, misleading or deceptive. False or misleading information in such reports, even when voluntarily provided, could in some circumstances attract criminal liability, such as under ss 1308 and 1309 of the Corporations Act, as well as civil liability for misrepresentation at common law or under the *Trade Practices Act 1974*. It should also be noted that external auditors are to some extent required to review non-financial as well as financial

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<sup>209</sup> **National Pollutant Inventory.** This involves a mixture of Acts, regulations and policy instruments implemented pursuant to an inter-governmental agreement: *Environment Protection Act 1997* (ACT); *Protection of the Environment Operations (General) Amendment (National Pollutant Inventory) Regulation 2002* (NSW); *Environmental Protection Regulation 1998* (Qld); *National Environment Protection Council (South Australia) Act 1995* (SA) (automatic adoption provisions); *State Policies and Projects Act 1993* (Tas) s 12A; *Industrial Waste Management Policy* (Vic); *Environmental Protection (NEPM-NPI) Regulations 1998* (WA).

<sup>210</sup> **Website.** [www.npi.gov.au](http://www.npi.gov.au)

<sup>211</sup> **Reporting on energy use.** The Act implements policies set out in the Australian Government White Paper *Securing Australia's Energy Future* (2004). Section 3 of the Act provides that:

- (1) The object of this Act is to improve the identification and evaluation of energy efficiency opportunities by large energy using businesses and, as a result, to encourage implementation of cost effective energy efficiency opportunities.
- (2) In order to achieve its object, this Act requires large energy using businesses:
  - (a) to undertake an assessment of their energy efficiency opportunities to a minimum standard in order to improve the way in which those opportunities are identified and evaluated; and
  - (b) to report publicly on the outcomes of that assessment in order to demonstrate to the community that those businesses are effectively managing their energy.

information in annual reports.<sup>212</sup> Liability may also arise from including misleading or deceptive non-financial material in a takeover document or prospectus.<sup>213</sup>

#### 4.4 Voluntary reporting

Companies may, and often do, choose to volunteer information about environmental and social matters to the market through various means, including:

- in their annual reports, over and above statutory requirements
- preparing a separate sustainability or other form of social responsibility report
- participating in environmental voluntary reporting initiatives<sup>214</sup>
- participating in relevant market indices<sup>215</sup>
- communicating by other means, such as targeting community opinion leaders or striving to achieve relevant ratings and awards, to convey a company's social goals and performance.<sup>216</sup>

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<sup>212</sup> **Audit of non-financial information in annual reports.** AUS 212 *Other Information in Documents Containing Audited Financial Reports* requires that the auditor 'should read the other [non-financial] information to identify material inconsistencies with the audited financial report ... Examples of other information include a report by management or the governing body on operations ... the auditor needs to give consideration to such other information when issuing an audit report on the financial report, as the credibility of the audited financial report may be undermined by inconsistencies which may exist between the audited financial report and other information'.

<sup>213</sup> **Liability for takeover document or prospectus.** ss 670A, 728.

<sup>214</sup> **Environmental reporting initiatives.** These voluntary initiatives include the Carbon Disclosure Project. See further footnote 275.

<sup>215</sup> **Market indices.** 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 annual survey of participating companies are reported in the *Sydney Morning Herald* and the *Age* in April or May of each year.

<sup>216</sup> **Informal disclosure.** 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.

## 4.5 Continuous disclosure

A public listed company or other 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’.<sup>217</sup> These disclosure 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.<sup>218</sup>

## 4.6 Annual reporting

### 4.6.1 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.<sup>219</sup>

Annual reports must be provided to company shareholders<sup>220</sup> and must also be lodged with ASIC and thereby be accessible to the public.<sup>221</sup>

### *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.<sup>222</sup>

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<sup>217</sup> **Continuous disclosure.** The obligations are set out in ss 674–678; ASX Listing Rule 3.1. Section 677 provides that information would have a material price effect on particular securities if it ‘would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the [relevant] securities’.

<sup>218</sup> **Unlisted disclosing entities.** s 675(1)(b). The same materiality test as in ASX Listing Rule 3.1 is set out in s 675(2)(a), (b). The tests for determining listed and unlisted disclosing entities are set out in Part 1.2A Div 2 of the Corporations Act.

<sup>219</sup> **Directors’ report.** ss 292–294.

<sup>220</sup> **Source.** s 314.

<sup>221</sup> **Source.** s 319.

Particular information about environmental or social aspects of corporate conduct may have to be included in the financial report if it has direct financial implications.<sup>223</sup> However, there is no general requirement that non-financial environmental and social aspects of a company's operations be covered in the financial report.<sup>224</sup>

The financial report can be of value for a range of users, not just shareholders.<sup>225</sup>

### *Directors' report*

The directors' report must include general information about the operation of the company, including its principal activities and outcomes during the year, as well as some forward-looking information.<sup>226</sup> Particular categories of non-financial information are required under ss 299(1)(f) and 299A.

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<sup>222</sup> **Source.** ss 295–297.

<sup>223</sup> **Non-financial information in financial reports.** 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 may have implications for environmental or social matters, for instance, in its 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 possibly arise from corporate publications (such as public reports or policy statements on a company's website) that outlined environmental or social undertakings or commitments by that company.

<sup>224</sup> **Environmental and other reports outside the financial report.** 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.

<sup>225</sup> **Utility of financial reports.** Australian Accounting Standards Board (AASB), *Framework for the Preparation and Presentation of Financial Statements* (July 2004) para 9 refers to the use of financial reports by a range of stakeholders including investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public.

<sup>226</sup> **Relevant provisions.** ss 298–300A.

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 application to an entity that is subject to 'particular and significant' environmental regulation constitutes a materiality threshold. The relevant aspects of performance to be reported on are not elaborated.

s 299A. This provision, applicable to annual reports of listed companies since 2005, is the first statutory requirement directed in broad terms at the reporting of non-financial information. Listed companies must include in the directors' report any information that shareholders would reasonably require to make an informed assessment of:

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

There is an exception for material the publication of which would result in 'unreasonable prejudice' to the company.<sup>227</sup>

Section 299A was introduced in response to a recommendation in the HIH Royal Commission report *The Failure of HIH Insurance* (April 2003) that an operating and financial review (OFR) should be included in annual reports.<sup>228</sup> The Royal Commissioner referred to the proposals at that time 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.

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<sup>227</sup> **Relevant provision.** s 299A(3).

<sup>228</sup> **Source.** vol 1 at Section 7.2.6 and Recommendation 13, and the Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 para 4.391.

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.<sup>229</sup>

Section 299A does not refer specifically to environmental or social issues. The Explanatory Memorandum to the Bill stated that the provision was 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
- to provide flexibility in form and content of the disclosures, as the information needs of shareholders, and the wider capital market, evolve over time.<sup>230</sup>

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.<sup>231</sup> That Guide refers to the disclosure of non-financial as well as financial information, a discussion and analysis of key financial and non-financial performance indicators, inclusion, where relevant, of sustainability measures, including social and environmental performance measures, and disclosure of information about unrecognised intangible assets, such as human resources, and customer and supplier innovations.<sup>232</sup>

Section 299A constitutes a significant development, with the potential to draw out more meaningful information as may be needed to meet the reasonable requirements of shareholders. Following an innovation of this kind, it may take some time to

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<sup>229</sup> **Source.** vol 1 at 182.

<sup>230</sup> **Source.** Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, para 5.306.

<sup>231</sup> **Source.** Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, paras 4.388, 5.307.

<sup>232</sup> **Source.** Further extracts from the *Guide* are set out under *Listing Rules* in Section 4.6.2, below.

assess any change in the quantity or quality of information reported. Importantly, being part of the directors' report, the information provided is subject to audit.

## 4.6.2 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 (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 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.<sup>233</sup>

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

It should outline the opportunities and risks in respect of the industries and locations in which the company operates and

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<sup>233</sup> **Source.** Group of 100 *Guide*, Overview.

the legal, social and political environments which affect the company and its activities.<sup>234</sup>

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.<sup>235</sup>

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.<sup>236</sup>

### *Corporate Governance Council principles*

The ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* set out guidelines for companies listed on the ASX. Draft reformulated Principle 7 (Recognise and manage risk) refers to companies disclosing their risk management policies and related matters, as well as the level of compliance with various risk management processes that are described in the Principle. However, Principle 7 does not require companies to disclose their actual material business risks, or changes to them over time.

The Council has called for submissions on whether it has a role in 'sustainability/corporate responsibility' reporting, which would include the disclosure of environmental and social risks<sup>237</sup> and, if so, whether that should be in the form of voluntary guidance with no additional reporting obligations or alternatively, an 'if not, why not'

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<sup>234</sup> **Source.** para 7.

<sup>235</sup> **Source.** para 8.

<sup>236</sup> **Source.** para 27.

<sup>237</sup> **Meaning of sustainability/CR reporting.** The ASX Corporate Governance Council Consultation Paper *Review of the Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006) in Part B para 6 states that:

In Council's view this type of reporting involves reporting on matters that are not necessarily reflected in a company's financial statements, but which relate to information described as 'other material business risks' in the revised Principle 7, such as operational matters, human capital, environmental matters, compliance, reputation or brand.

reporting obligation.<sup>238</sup> The Council noted that some companies have chosen to report sustainability/corporate responsibility information in the context of the Principles, or separately.<sup>239</sup> The Council position on these matters is expected to be settled in 2007.

### *Web-based information disclosure*

The ASX Corporate Governance Council in November 2006 sought submissions on whether it should recommend to the ASX that it consult on establishing a web-based tool for the dissemination of sustainability information, similar to the Corporate Responsibility Exchange conducted by the London Stock Exchange.<sup>240</sup>

## 4.7 Overseas reporting requirements

Over the last decade, there has been a shift towards greater disclosure by corporations of their environmental and social impact.

### 4.7.1 USA

#### *SEC regulations*

The Securities and Exchange Commission (SEC) reporting obligations under Items 101, 103 and 303 of Regulation S-K include environmental disclosure requirements.<sup>241</sup> 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.

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<sup>238</sup> **Whether to introduce sustainability/CR reporting.** id at paras 33-57 of Part B.

<sup>239</sup> **Level of sustainability/CR reporting.** id at paras 14-18 of Part B.

<sup>240</sup> **Source.** id at paras 58-62 of Part B.

<sup>241</sup> **Source of SEC requirements.** The SEC approach to non-financial disclosure was largely based on the Jenkins Report *Improving Business Reporting: A Customer Focus* (AICPA, 1994).

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.

### *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.

### *SEC Item 101*

A registrant is required 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.

### *SEC Item 103*

A registrant must 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 environmental legislation.

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.

### *SEC 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 of the Corporations Act, 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.<sup>242</sup>

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

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<sup>242</sup> **Source.** SEC Press Release 2003–179 (19 December 2003).

### *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 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 utility] must demonstrate measurable improvements in environmental performance, implement an environmental management system and expand its stakeholder involvement program. In exchange, [the utility] will benefit through permit streamlining, alternative monitoring and more flexible operations.

### **4.7.2 European Union**

Starting in the 1990s, various EU countries introduced obligations on companies to include in their annual reports information about the environmental and social impact of their activities and the ways in which they manage that impact.<sup>243</sup>

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 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.<sup>244</sup>

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<sup>243</sup> **EU initiatives.** 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.

<sup>244</sup> **Source.** EU Commission Recommendation 30 May 2001 (2001/453/EC) at (4).

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.<sup>245</sup>

This proposal provided the context for the *EU Accounts Modernisation Directive* (June 2003), which expanded the reporting obligations of EU corporations beyond the financial to the environmental and social aspects of their operations.<sup>246</sup> The Directive 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.<sup>247</sup>

The Directive includes a requirement for large and medium EU companies to provide the following information in their annual reports for financial years commencing from 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.

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

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<sup>245</sup> **Source.** id at (10).

<sup>246</sup> **EU June 2003 Directive.** Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003.

<sup>247</sup> **Source.** id at (9).

particular business, including information relating to environmental and employee matters.<sup>248</sup>

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 and some other EU countries have passed legislation closely following the language of the EU Directive. The United Kingdom originally adopted more comprehensive disclosure provisions, but these were subsequently withdrawn, to be replaced with modified requirements.

### 4.7.3 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 Accountants 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 reports social, ethical and environmental risks and opportunities, and how they are managed.<sup>249</sup>

In March 2005, a mandatory requirement was introduced for UK listed companies to include in their directors' report an operating and financial review (OFR) for their reporting years beginning on or after April 2005. However this requirement, the culmination of a

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<sup>248</sup> **Source.** Directive 78/660/EEC, Article 46(1)(a), (b) as amended by Directive 2003/51/EC, Article 1.14(a).

<sup>249</sup> **UK voluntary initiatives.** The Association of British Insurers report, *Risk Returns and Responsibility* (February 2004) provides a useful summary of these guidelines. The 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. 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.

government-initiated review process over a number of years,<sup>250</sup> was withdrawn before it became operative, though companies could still include an OFR if they chose. Under the discontinued OFR requirements, which would have gone beyond the requirements in the EU *Accounts Modernisation Directive*, UK listed companies would have been required to set out a range of forward-looking information concerning resources, risks, uncertainties and relationships that may affect the company's long-term value. These were foreshadowed to include, 'to the extent necessary', information about a range of matters including employees, the environment, social and community issues, along with the complementary use of key performance indicators.

The recently enacted UK *Companies Act 2006* brings together elements of the previous OFR and the requirements of the EU *Accounts Modernisation Directive*.

Under the Act, all companies other than small companies must produce a business review (as part of the directors' report). The business review must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. The review must be a balanced and comprehensive analysis of the company's business, consistent with the size and complexity of the business. In the case of quoted companies, this must include information about environmental matters, the company's employees and social and community issues, to the extent necessary for an understanding of the business. The review must also include analysis using financial key performance indicators (KPIs) and, where appropriate, non-financial KPIs, including information relating to environmental and employee matters. There are various exemptions, including from disclosing seriously prejudicial information.

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<sup>250</sup> **Company Law Review.** The Company Law Review, 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), on the introduction of a statutory OFR. The amendments to the Companies Act to require an OFR came into force in April 2005, but were subsequently discontinued.

One key difference between the previous OFR and the requirements in the Act is that the higher level of audit check contemplated under the OFR is not required. The UK Accounting Standards Board will provide voluntary guidance on the narrative reporting requirements in the Act.

According to the UK Department of Trade and Industry:

The Act promotes forward looking narrative reporting by companies covering risks as well as opportunities, together with explicit requirements for quoted companies to report, as part of their business review and to the extent necessary for an understanding of the business, information on (i) environmental matters, (ii) employees and (iii) social and community issues, including information on any policies relating to these matters and their effectiveness, plus contractual and other relationships essential to the business.<sup>251</sup>

#### 4.7.4 France

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

Legislation enacted in 2001, and operative from 2003,<sup>252</sup> requires all French companies listed on the ‘premier marché’ (those with the 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’.<sup>253</sup>

Other legislation<sup>254</sup> established various corporate sustainability reporting indicators, including on human resources,<sup>255</sup> community

<sup>251</sup> **Source.** Press Release, 8 November 2006.

<sup>252</sup> **French legislation.** *Nouvelles Régulations Économiques* (No 2001-420).

<sup>253</sup> **Overview of French requirements.** A useful summary of the French requirements is found in the Institute of Chartered Accountants in Australia report *Extended performance reporting: An overview of techniques* (January 2006) at 2.2.

<sup>254</sup> **French legislation.** Assemblée Nationale Decree No 2002-221.

<sup>255</sup> **Human resources.** These include detailed information relevant to total workforce, including working hours, industrial relations and health and safety conditions.

issues and engagement,<sup>256</sup> labour standards<sup>257</sup> and the environmental impact of corporate activities.<sup>258</sup>

#### 4.7.5 Germany

The principles in the *EU Accounts Modernisation Directive* apply to annual reports for larger German companies for financial years beginning from January 2005.

The German law closely reflects the wording in that Directive.<sup>259</sup> The accompanying explanatory statement 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.<sup>260</sup>

#### 4.7.6 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

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<sup>256</sup> **Community issues.** 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.

<sup>257</sup> **Labour standards.** 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.

<sup>258</sup> **Environmental impact.** These include energy use and efficiency, biological damage and protection, conformity with legal obligations, expenditures to prevent the consequences of any activity detrimental to the environment and information concerning environmental risks and any compensation paid for environmental damage.

<sup>259</sup> **German legislation.** Handelsgesetzbuch (the German Commercial Code) §289, as amended by the Bilanzrechtsreformgesetz (Accounting Law Reform Act) (2004).

<sup>260</sup> **Disclosure of environmental and social matters.** The requirements to include environmental and social matters are also reflected in German Accounting Standard 15, which emphasises the importance of including qualitative as well as quantifiable information in annual reports.

from the second King Report into corporate governance (King II).<sup>261</sup> That report contained a Code of Corporate Practices and Conduct, which applies to companies with securities listed on the JSE.<sup>262</sup> Under ‘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 for disclosure, having regard to the company’s particular circumstances.<sup>263</sup>

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).<sup>264</sup>

The JSE created the ‘SRI Index’ as a means to identify those corporations listed on the JSE that integrate the sustainability reporting guidelines into their business activities, and as a way of increasing compliance with the King II recommendations. To be included in the index, companies must meet stipulated criteria. They are then scored according to their level of adoption and implementation.

#### 4.7.7 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.

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<sup>261</sup> **Source.** *King Report on Corporate Governance in South Africa 2002* (King II) (March 2002).

<sup>262</sup> **Source.** id at 1.1.1.

<sup>263</sup> **Source.** id at 5.1.1.

<sup>264</sup> **Source.** id at 5.1.3.

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 on 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. Guidance from the Canadian Institute of Chartered Accountants (CICA) suggests that social and environmental issues are examples of risks that could materially affect a company’s future performance.<sup>265</sup>

A proposed guidance note by CICA with respect to environmental issues goes further by suggesting 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.<sup>266</sup>

#### 4.8 PJC Report

The recommendations of the Parliamentary Joint Committee on Corporations and Financial Services were that:

- sustainability reporting in Australia remain voluntary
- each company auditor review annually the extent to which companies are making non-financial disclosures and make recommendations to the board regarding the adequacy of those disclosures
- the ASX Corporate Governance Council provide further guidance on Principle 7 of its *Principles of Good Corporate*

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<sup>265</sup> **MD&A Guidance.** This guidance was issued by CICA in 2002 and revised in 2004.

<sup>266</sup> **Source.** CICA Interpretative Release, *Disclosing the Financial Impact of Climate Change and Other Environmental Issues* (March 2005).

*Governance and Best Practice Recommendations* and undertake industry consultation regarding further possible guidance on non-financial disclosures under these principles

while the recommendations of the Labor members were that:

- reporting against sustainability targets be mandatory for Australian government agencies
- the Corporations Act be amended to require all public and private companies above a specified size threshold to disclose publicly their top five sustainability risks and their strategies to manage such risks
- the Australian Government set out targets for the uptake of detailed sustainability reporting in Australia
- ASIC undertake annual reviews of the extent to which companies are making non-financial disclosures.<sup>267</sup>

## 4.9 Views in submissions

The Advisory Committee received a range of views in submissions on whether the Corporations Act should require certain types of companies to report on the social and environmental impact of their activities, and if so, in what form. The submissions on this topic are summarised below, with a more detailed version of that summary set out in *Summary of submissions*, available at [www.camac.gov.au](http://www.camac.gov.au)

### 4.9.1 Overview of submissions

There was considerable support for the principle that social and environmental reporting is desirable, as financial reporting provides only a partial view of a company's operations.

Some respondents considered that the current mixture of voluntary and mandatory non-financial reporting (as set out in Sections 4.3-4.6

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<sup>267</sup> **PJC report.** *Corporate responsibility: managing risk and creating value* (June 2006). Relevant recommendations of the majority are at Recommendations 5, 8, 10 and 11 and those of the Labor members are at Recommendations 3, 10, 11 and 12 of the supplementary report.

of this report) sufficed, with any further initiatives concerning environmental and social reporting being left to voluntary action. Others considered that current disclosure arrangements were inadequate and that additional mandatory environmental and social reporting should be introduced.

### *Factors*

A number of issues were identified by respondents as relevant to the question of additional environmental and social reporting:

- *comparability*: some argued that additional mandatory reporting was necessary to ensure comparability of non-financial reports, while others thought this could be achieved through voluntary reporting under enhanced industry frameworks or guidelines
- *cost*: some respondents thought that any additional mandatory reporting would be too costly, while others argued that further mandatory reporting could, in effect, reduce costs by standardising requirements, or that the benefits of enhanced reporting would outweigh the cost
- *flexibility*: some respondents favoured voluntary reporting as it encourages flexibility, while respondents who favoured additional mandatory reporting thought that flexibility could be achieved by linking the reporting requirements to industry specific guidelines
- *innovation*: some respondents said further mandatory social and environmental reporting would stifle innovation, while others said that flexible mandatory reporting could create incentives for firms to develop innovative and cost-effective reporting methods
- *market advantage*: some respondents argued that enhanced mandatory reporting would reduce 'greenwash' (selective positive-only reporting) and thereby benefit responsible companies by improving their standing among risk analysts. Other respondents favoured voluntary reporting, as it would allow companies who took the initiative with disclosure of their environmental and social performance to portray themselves more positively in the market.

#### **4.9.2 Support further mandatory reporting**

Points made in submissions in support of additional mandatory social and environmental reporting included:

- current disclosure requirements are insufficient, particularly in relation to:
  - negative information
  - comparability of data, and
  - general credibility
- more reliable and comparable data through additional reporting would be useful to investors and analysts in considering the future prospects of companies
- mandatory reporting of negative impacts would provide incentives for improved corporate practices
- the imposition of a common standard may reduce implementation costs and be less expensive than producing costly voluntary reports that have a public relations focus
- any increased compliance costs would be offset by risk reduction and increased stakeholder confidence, as well as by non-economic factors such as employee satisfaction and corporate reputation
- the broader economy would benefit as companies are forced to disclose previously unacknowledged costs of their activities
- reliable and comparable additional reporting may assist in attracting capital from the growing SRI sector
- additional mandatory reporting would bring Australia into line with developments in European and some other countries
- enhanced reporting could improve dialogue between companies and relevant interest groups
- enhanced reporting would provide a basis for regulators to make informed policy decisions and identify areas where further regulation may be necessary.

### **4.9.3 Oppose further mandatory reporting**

Points made in opposition to further mandatory reporting included that it would:

- limit a company's ability to determine what best suits its needs and the expectations of its stakeholders
- involve undue cost, including for small and medium companies or those for whose businesses environmental or social issues were not material
- stifle innovation and competition between companies and the evolution of best practice
- foster minimum compliance and a 'tick the box' approach.

Respondents also argued that:

- it is difficult to mandate meaningful and consistent specific non-financial reporting standards that could apply to all companies without being either too complex and prescriptive or too high level to provide practical guidance
- any attempt to mandate further non-financial reporting would be premature and counterproductive, given emerging developments and changing and diverse needs of interest groups and the community in Australia and elsewhere.

### **4.9.4 Views on any further reporting**

#### ***Voluntary reporting***

Many submissions favoured continuing with voluntary disclosure initiatives, with support expressed for the GRI as the guideline for this form of reporting.

Some respondents favoured a mixture of voluntary reporting and additional mandatory disclosure, with the voluntary and mandatory elements being clearly distinguishable.

Some other submissions advocated further focus on voluntary reporting initiatives, with support from government, such as:

- subsidised implementation costs
- development of the credibility and rigour of published benchmarks and indices
- a requirement for appropriate management of any conflicts of interest on the part of operators of voluntary reporting indices.

### *Additional guidance*

Some respondents suggested the enhancement of s 299(1)(f), relevant accounting standards or the ASX Corporate Governance Principles, with best practice guidance on environmental and social reporting to be developed by government, the ASX or industry. They suggested that this approach would enable refinement of the guidelines over time as preparers gained experience in the practicalities of reporting.

### *Expanded exchange-based reporting*

A number of respondents suggested the incorporation of additional social and environmental reporting elements into the ASX guidelines.

Some submissions supported mandatory reporting under the ASX listing rules.

### *Legislative reporting requirements*

Various submissions proposed including ‘if not, why not’ environmental and social reporting requirements in the Corporations Act or regulations. This framework could be limited to disclosure of policies or be expanded to incorporate as many elements of GRI and industry sector reporting as are considered appropriate.

Some submissions proposed the inclusion of various additional mandatory reporting requirements in the Corporations Act. Others suggested that any need for additional disclosure should be dealt with in legislation tailored to particular industry sectors. One submission supported development by the government or the ASX of minimum mandatory standards for companies that choose not to adopt a satisfactory voluntary reporting framework.

## 4.9.5 Content of any additional reporting

### *Possible specific requirements*

Respondents who supported additional reporting requirements identified a range of matters that could be included, such as:

#### *Business processes*

- policies and procedures relating to corporate social responsibility matters
- external processes (such as consultation with stakeholders)
- community relations and impacts
- how decision-making and strategy are informed by responsibility considerations
- supply chains—listing major clients, suppliers and countries of operation

#### *Environmental*

- resource use—quantitative usage reporting of electricity, water and industry-specific non-renewable inputs
- emissions—of carbon dioxide and air, land and water pollutants
- qualitative information—reporting of general environmental impacts

#### *Legal compliance*

- material non-compliance with Australian law—particularly breaches of environmental and occupational health and safety regulations
- material non-compliance with overseas laws

#### *Government relationships*

- political donations
- subsidies and export finance

- extraction licence fees

#### *International conventions*

- material non-compliance with international conventions such as human rights and labour standards for transnational corporations.

#### **4.9.6 Scope of requirements**

Some submissions questioned how far any additional reporting requirements should extend, for instance:

- *geographic limits*—would there be any geographic limitations on the information that a company is required to report
- *quantitative limits*—should environmental impact reporting be subject to minimum thresholds?

#### **4.9.7 Who should be required to report**

There were differing views in submissions on who should be required to report on social and environmental matters, including:

- listed public companies
- listed and unlisted public companies
- ‘large proprietary companies’ (as defined by the Corporations Act)
- all companies of a particular size or engaged in particular businesses
- the largest 500 companies, by revenue, market capitalisation or asset value
- companies in industries with significant social and environmental risk profiles
- all entities ‘whose activities have a significant environmental or social impact’, whether or not they are companies.

## 4.9.8 Other aspects of reporting

### *Verification*

Many respondents considered that, in principle, non-financial reports should be externally verified, as:

- verification by auditing or consulting firms would enhance integrity and add credibility to reports
- private verification would decrease reliance on regulatory authorities
- verification would reduce the gap between internal and external information.

Alternatively, it was suggested that companies should at least have to disclose whether a report has been verified.

### *Form of reports*

Submissions suggested that reports should be in a consistent form to assist in accessibility, reliability and comparability. The GRI was seen by some as ‘a convenient and widely accepted framework’ to achieve consistency. Alternatively, if a domestic alternative is sought, compliance with the ASX Corporate Governance Principles could be made mandatory.

### *Narrative or quantitative reporting*

Some submissions said that information on the environmental and social performance of companies should be in a quantitative form where possible. This would:

- reduce subjectivity
- aid comparison of performance over time and between companies, and
- enhance the scope for independent assurance.

However, others argued that particular dimensions of performance are best encapsulated in narrative comment. The relevant test should be user utility and comprehension.

## 4.10 Advisory Committee view

Transparency is a cornerstone of responsibility in the operation of corporate businesses, just as it is in the activities of other organizations, whether private, public or not-for-profit. Disclosure to the public of relevant information about a company enables interested parties—be they shareholders, customers, employees or others—to evaluate and respond to the way its business is being conducted. The very process by which information is collected and disseminated can also focus corporate managers on identifying and dealing with issues.

As interest grows in the way that companies carry on their businesses, and in the wider impacts of corporate activities, changes are already under way in the nature and amount of information that is being disseminated. In many cases, companies whose activities touch areas of community concern are themselves putting more effort into explaining their own practices and contributions to the community. Interest groups are also active in gathering and disseminating information and various regulators add to the mix. This is a dynamic process that can be expected to continue, with changes in focus over time as attention given to various issues waxes and wanes.

### Legislation

In reporting as in other areas, the appropriate role of corporate regulation is usually to set minimum standards where intervention is judged necessary. The Corporations Act already places an emphasis on disclosure, with a range of reporting requirements, particularly for companies that look to the public for their funding. There has long been an emphasis on the reporting of financial information relevant to the performance and strength of a company. Increasingly, the reporting of financial information has to be accompanied by information, some qualitative rather than quantitative, that describes or analyses other aspects of a company's activities or performance. In the Advisory Committee's view:

- there is a considerable overlap in aspects of corporate performance that are of potential interest to investors and other groups or the public in general

- to that extent, the general disclosure and reporting regime for companies provides an appropriate and useful platform for dissemination of information about relevant corporate activities
- the areas of overlapping investor and broader community interest can generally be characterised from the corporate perspective as going to activities or aspects of a business that touch on or pose risks to the company's ongoing success (these might include, for example, safety aspects of a product or the environmental consequences of a business operation)
- it should be noted, however, that the current reporting regime under the Corporations Act is an imperfect mechanism for meeting the needs of interest groups extending beyond investors; there is at most a rough correlation between entities such as public listed companies that are subject to the most extensive disclosure requirements and entities whose business activities may be of interest to the wider community
- furthermore, the collection and disclosure of information is not a cost-free exercise and the Corporations Act reporting regime is a rather blunt instrument if used for the collection from a broad category of companies of information of a kind that may be material only in the case of some of them.

Accordingly, in the Advisory Committee's view, the Corporations Act reporting regime is apt and has potential as a platform for drawing out information relevant to a company's business performance and prospects. It should not, however, be used to achieve disclosure ends that go beyond its underlying rationale.

Section 299A of the Corporations Act already provides an appropriate platform for the disclosure of non-financial information material to the business of a listed company. The obligation of directors to disclose information that shareholders would reasonably require to make an informed assessment of their company's operations, financial position, business strategies and future prospects is a powerful one. While avoiding detailed prescription, the reporting threshold is capable of triggering disclosure of information about emerging issues, whether of an environmental, social or economic kind, that would be seen by the market as impacting on the company's business. It would be premature and counterproductive to introduce detailed legislative social and

environmental reporting requirements, given that the form and content of non-financial disclosures are still evolving, internationally as well as locally.

As noted in the Explanatory Memorandum when s 299A was introduced, there is scope for best practice guidance, such as the Group of 100 Inc publication *Guide to the Review of Operations and Financial Condition*, to evolve and to guide directors in their approach to non-financial reporting.

It should be noted that s 299A applies only to listed public companies. The Committee considers that this provision should be extended to all listed entities, taking into account that non-corporate listed entities, including listed managed investment funds, now constitute over 10% of all listed entities. It is anomalous that these other listed entities are not covered.

The benefits of further extending s 299A beyond listed entities to, say, unlisted disclosing entities,<sup>268</sup> unlisted public companies,<sup>269</sup> or large proprietary companies,<sup>270</sup> are less clear. While the population of listed entities includes a large number of the most prominent corporate businesses, the activities of some other corporate bodies may well be of concern to some interest groups. As the Committee sees it, the broad reporting requirement of s 299A rests on an investor protection rationale. Some may take the view that, even for entities that do not have public investors, the reporting obligations in s 299A should apply. The Committee, however, is not persuaded that the potential interest of other elements of the community in particular aspects of the activities of some non-listed companies is sufficient justification for a wholesale expansion of the category of reporting entities beyond those that are listed to any of the other existing categories of entities or companies under the Corporations Act.

The Advisory Committee does not favour a piecemeal approach to reporting on social and environmental issues by the inclusion in the

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<sup>268</sup> **Disclosing entities.** The tests for listed and unlisted disclosing entities are set out in Part 1.2A Div 2 of the Corporations Act. These tests have an investor protection focus. For instance, an entity will be a disclosing entity if it has issued a prospectus or has more than 100 investors.

<sup>269</sup> **Public company.** Section 9 of the Corporations Act defines a 'public company'.

<sup>270</sup> **Large proprietary company.** The tests for determining what is a large proprietary company are set out in s 45A(3) of the Corporations Act.

Corporations Act of further specific provisions along the lines of s 299(1)(f).

The Committee recognises that, from time to time, governments may see a need on discrete public interest grounds to require businesses to report on particular matters, whether relating to environmental, social or other concerns. In those circumstances, specific legislation tailored to the specific purpose and extending to all businesses thought to be relevant, whether they be corporate or non-corporate, public or private, for profit or non-profit, would generally seem to be more appropriate than use of the Corporations Act. An example of this may be the *Energy Efficiency Opportunities Act 2006*.

### ASX and voluntary reporting

The Advisory Committee considers that reporting initiatives by the ASX, through its Listing Rules and the ASX Corporate Governance Council principles and recommendations, as well as voluntary reporting under various industry and international initiatives, have benefits of flexibility and responsiveness to change that cannot be achieved as readily through legislative prescription.

The ASX is in a position to adjust relevant listing rules or corporate governance principles in response to changing market demand or expectations and to strike a balance between the interests of outside parties in disclosure and considerations of commercial confidentiality.

Beyond legislative prescription and ASX reporting initiatives, the nature and quality of corporate reporting on issues that go beyond any narrow view of financial performance can be expected to evolve. Reporting practices will be shaped by individual corporate initiatives in a competitive context, as well as by industry-sponsored or other initiatives, such as the Global Reporting Initiative, which recommend best practice guidelines.

Voluntary initiatives of this kind may provide a useful model and possible commercial benefits for companies that choose to follow them. There is something to be said for allowing the current activity in this area to continue rather than cutting across it by legislative prescription, particularly where recommended practice is still at a formative stage.

### **Integrity of reports**

To the extent that companies do report on non-financial as well as financial matters, whether in response to legislative requirements or ASX initiatives or on a voluntary basis, the public is entitled to expect that the information provided is soundly based. Corporate businesses generally operate under a more demanding legal regime in relation to false, misleading or deceptive statements than do other businesses, government bodies, NGOs and so on. Various provisions in the Corporations Act and the Trade Practices Act 1974 make companies—and in some cases company officers—liable for inaccurate or misleading statements. The Committee does not see a need for these provisions to be extended. It notes that companies may in their own interests utilise external assurance bodies to verify non-financial information that they disclose to the public. As indicated earlier, this is an area where external auditors have some responsibilities. ASIC and other regulatory agencies also have a role in this area.

## 5 Promotion of responsible practices

*In considering possible further steps to encourage companies to adopt socially and environmentally responsible business practices, this chapter reviews a range of voluntary industry and market initiatives as well as government measures, summarises the views and proposals in submissions and sets out the Advisory Committee's conclusions.*

### 5.1 Context

The point has been made already that, while interest in certain aspects has grown, issues relating to the social responsibility of corporations are not new. Individual companies, like other organizations, are and should be judged according to the way they act and the extent to which they take responsibility for their actions, whether in relation to customers, their employees, the environment or otherwise.

In response to growing concerns about social and environmental aspects, there is already a good deal of activity in the marketplace, including action by individual companies to place more emphasis on their practice and reporting in these areas, as well as initiatives by industry groups, NGOs and others to develop voluntary 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 concerns of shareholders or other interest groups.

It was noted in the Advisory Committee's terms of reference that there may be a positive role for government to play in promoting socially responsible behaviour through various initiatives such as voluntary codes of practice. The Committee was asked to consider:

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

Before considering whether further steps are necessary or useful, reference is made to various voluntary initiatives being undertaken at industry and market level, in conjunction with NGOs or other interest groups, as well as various 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 and 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

Self-regulatory codes of conduct and other initiatives at industry level include:

- *Australian Minerals Industry Framework for Sustainable Development (Enduring Value)*, a voluntary code established by the Minerals Council of Australia to encourage mining companies to improve their environmental performance beyond regulatory compliance, including through the preparation of an annual report on environmental management based on GRI indicators
- *Mining Certification Evaluation Project*, 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
- *Australian Business Roundtable on Climate Change*, a body comprising large businesses and a prominent NGO, which has released *The Business Case for Early Action* (April 2006) concerning greenhouse gas emission targets
- *Credit Union Foundation Australia*, which has developed a Toolkit to help credit unions educate themselves about corporate social responsibility matters and assist them in generating

sustainability reports that follow an international reporting framework, including the GRI.

### 5.2.2 International

Industry-based organizations that have taken action include:

- *Business in the Community (BITC)*, a voluntary organization of over 750 companies, established in the UK in the 1980s in response to high levels of unemployment and urban unrest with the goal of working ‘to develop practical and sustainable solutions to manage and embed responsible business practice’ and undertaking a range of philanthropic and other community-based corporate projects, including publishing an annual corporate responsibility index
- *Corporate Responsibility Group*, a UK industry body comprising some 80 of the largest UK companies, which promotes social, ethical and environmentally responsible approaches to business practice
- *Business for Social Responsibility*, a global organization established in 1992 with the goal of helping member companies achieve success in ways that respect ethical values, people, communities and the environment
- *CSR Europe*, a European multinational business network established in 1995 with the goal of helping companies integrate corporate social responsibility concepts into everyday business practices<sup>271</sup>
- *European Alliance on CSR*, a voluntary organization established in March 2006, supported by the EU Commission and comprising large enterprises, small to medium enterprises and

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<sup>271</sup> **CSR Europe.** See *A European Roadmap for Business: Towards a Sustainable and Competitive Enterprise* for its goals and guiding principles. In October 2006, CSR Europe released the initial results of a study that aims to produce an ongoing European Cartography on corporate social responsibility.

various stakeholder groups seeking to advance various corporate social responsibility goals and initiatives.<sup>272</sup>

Other relevant industry-based bodies include the *World Council for Corporate Governance* and the *European Business Ethics Network*.

### 5.2.3 Guidelines

Various internationally recognised or applied corporate conduct guidelines developed by industry or investor bodies<sup>273</sup> include:

- *Caux Principles* for ethical and responsible corporate behaviour, sponsored by senior business leaders from Europe, Japan and North America
- *Ceres Principles*, a ten point code of corporate environmental conduct to be publicly endorsed by participating companies as an environmental mission statement
- *Greenhouse Gas Protocol Initiative*, which aims to ensure that different trading schemes and other climate related initiatives adopt consistent accounting and reporting approaches in relation to greenhouse gas emissions
- *Global Sullivan Principles* on labour, business ethics and environmental practices of multinational companies
- *Ethical Trading Initiative*, which requires participant companies to adopt a code of labour practice, based on ILO Conventions, to improve working conditions in their supply chain companies in developing countries<sup>274</sup>

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<sup>272</sup> **European Alliance on CSR.** The details are set out in the Commission of the European Communities paper, *Implementing the Partnership for Growth and Jobs: Making Europe a pole of excellence on CSR* (March 2006).

<sup>273</sup> **Guidelines.** K McKague & W Cragg, *Compendium of Ethics Codes and Instruments of Corporate Responsibility* (September 2005) provides a list of relevant codes and guidelines. See also R Goel & W Cragg, *Guide to Instruments of Corporate Responsibility* (October 2005).

<sup>274</sup> **Voluntary labour codes.** The Institute of Development Studies report *The ETI code of labour practice: do workers really benefit?* (October 2006) finds that voluntary codes of labour practice have had positive impacts in developing countries on health and safety, wages and child labour practices, but less impact to date in relation to freedom of association, discrimination and regularity of employment.

- *Eco-Management and Audit Scheme (EMAS)*, established in the EU and requiring participating organizations to implement environmental management systems and periodically report on their environmental performance
- *Business Charter for Sustainable Development*, designed by the International Chamber of Commerce to encourage companies to improve their environmental results
- *Carbon Disclosure Project*, under which major institutional investors request information from large corporations about their greenhouse gas emissions and the extent to which they have integrated fossil fuel risk factors into their operations<sup>275</sup>
- *Global Framework for Climate Risk Disclosure* in which a group of international institutional investors have provided specific guidelines regarding the information they would like companies to disclose on the financial risks posed by climate change. The aim is to complement information provided under the Carbon Disclosure Project

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<sup>275</sup> **Carbon Disclosure Project.** Reports are published annually, based on information obtained primarily from FT500 companies (the 500 largest publicly traded companies in the world by market capitalisation). The CDP website claims to be the largest registry of corporate greenhouse gas emissions in the world.

The 2006 report (CDP4) indicated that 72% of companies in the FT500 responded to the survey, an increase from 47% when the survey was first conducted in 2003, and that there was a significantly increased response level from US companies (from 42% in 2005 to 58% in 2006). Key findings included that:

- 87% of responding companies indicated that climate change represented commercial risks and/or opportunities for them
- in North America, 'clean tech' has become the fifth largest venture capital investment category, behind biotechnology, software, medical and telecommunications.

CDP4 concluded that 'climate change and shareholder value are inextricably linked'.

The Investor Group on Climate Change Australia/New Zealand surveys ASX100 and NZ50 companies on behalf of the CDP. Its *Carbon Disclosure Project Report 2006 Australia & New Zealand* (October 2006) reported that 57% of ASX 100 companies responded. While there was a general appreciation amongst respondents of climate change and its potentially detrimental impact on profits, only a small minority of respondents indicated that they had set targets to reduce energy use or greenhouse emissions. The report found that:

- few companies fully quantify and verify emissions from owned and controlled entities
- most emission reduction initiatives do not have clearly defined targets and timelines.

- *Equator Principles*, under which participating financial institutions agree that major projects they finance will be developed in a socially responsible manner that reflects sound environmental management practices<sup>276</sup>
- *United Nations Environment Program Finance Initiative*, with similar goals to the Equator Principles, involving a partnership between the UN and the private financial sector under which finance industry participants agree to identify, promote and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations
- *Extractive Industries Transparency Initiative*, which aims to increase transparency concerning payments by mining companies to governments and government-linked entities, as well as transparency concerning revenues paid to host country governments<sup>277</sup>
- *Responsible Care Global Charter*, developed by the International Council of Chemical Associations to improve monitoring, and disclosure of progress, in relation to health, safety and environmental performance in their industry.

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

### 5.3 Other market initiatives

#### 5.3.1 ASX Corporate Governance Council

As noted earlier, the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice* for Australian

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<sup>276</sup> **Equator Principles.** These principles, revised in July 2006, have been adopted by over 40 financial institutions around the world. They are based on social and environmental policies of the World Bank and the International Finance Corporation Performance Standards.

<sup>277</sup> **Assessment of the Initiative.** The report by PWYP [Publish what you pay, an organization of over 300 NGOs worldwide] *Eye on EITI* (October 2006) outlines progress since the Initiative was launched in 2002 and various recommendations to improve financial transparency.

listed entities set out various standards in relation to environmental and social factors.

### 5.3.2 Standards Australia

Australian Standard *AS 8003-2003 Corporate social responsibility*, somewhat comparable to the ASX Corporate Governance Council principles, is aimed at non-listed companies and not-for-profit organizations.<sup>278</sup> This standard, like the ASX guidelines, is intended as a guide for a self-regulatory approach. The standard deals with issues concerning employees, the environment and health and safety, amongst other things.

### 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 a number of ASX-listed companies.<sup>279</sup>

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<sup>278</sup> **Standards Australia Series.** *AS 8003-2003* is part of a five-part suite of corporate governance standards, the others being *AS 8000-2003* (good governance principles), *AS 8001-2003* (fraud and corruption control), *AS 8002-2003* (organizational codes of conduct) and *AS 8004-2003* (whistleblower protection programs for entities).

<sup>279</sup> **Corporate Responsibility Index.** This index, begun in 2004, with the St James Ethics Centre acting as ‘trustee’ of the process, comprises four components that require participating companies to show how they have dealt with environmental and social issues in terms of:

- *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
- *implementation*: this focuses on 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.

Results of the annual surveys of participating companies are reported in the *Sydney Morning Herald* and the *Age*, usually in April or May.

Other relevant indices in Australia include the Sustainable Asset Management Index (AuSSI)<sup>280</sup> and the Reputex SRI Index.<sup>281</sup>

### 5.3.4 Overseas exchanges and indices

The Dow Jones Sustainability Index (DJSI), established in 1999, rates the leading 10% of the companies in the Dow Jones Global Index, based on economic, environmental and social criteria, including environmental protection, sustainability, social issues, stakeholder relations and human rights. A similar European Index, DJSI STOXX, was launched in 2001, and DJSI North America and DJSI United States were launched in September 2005.

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

The Johannesburg Securities Exchange in 2003 created an 'SRI Index' to identify 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, while the Domini 400 Social Index monitors the environmental and social performance of various large US corporations.

## 5.4 Educational initiatives

An increasing number of business schools around the world are introducing social responsibility subjects into the curriculum, such

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<sup>280</sup> **AuSSI.** This index was launched in February 2005 by Sustainable Asset Management Australia.

<sup>281</sup> **Reputex SRI.** This index, launched in August 2005, covers corporate governance, environmental impact, social impact and workplace practices.

as ‘business ethics and corporate responsibility’, ‘business strategies for emerging markets’ and ‘corporate environmental management’.<sup>282</sup> Similar initiatives have been undertaken to promote the inclusion of relevant issues in courses at Australian business schools.<sup>283</sup>

## 5.5 Government-industry initiatives

### 5.5.1 Prime Minister’s Community Business Partnership

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

The Roundtable later became the Prime Minister’s Community Business Partnership. Its members are prominent Australians from the community and business sectors, appointed by the Prime Minister to advise and assist the Government on issues of

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<sup>282</sup> **Global initiatives.** According to the report *Beyond Grey Pinstripes* (World Resources Institute and the Aspen Institute, 2005), of 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 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.

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, comprising 21 global businesses and business schools, is to examine and make recommendations (1) to offer tangible direction on how to integrate the teaching of global corporate citizenship into the curricula of business schools; (2) to offer tangible direction on how to integrate 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.

<sup>283</sup> **Australian initiatives.** Various initiatives are referred to in D Tilbury, C Crawley & F Berry (2004), *Education About and For Sustainability in Australian Business Schools*, a report prepared for the Department of the Environment and Heritage by the Australian Research Institute in Education for Sustainability (ARIES) and Arup Sustainability.

community-business collaboration. The Partnership's goals include identifying and addressing incentives and impediments to corporate social responsibility in Australia. Its role includes research, advocacy, facilitation and recognition of corporate social responsibility and encouragement of partnerships between business and community organizations.

Partnership initiatives include:

- *Workplace Giving*, a project that deals with philanthropy by corporate employees
- *Community and Business Partnerships Brokerage Service*, administered through the Department of Family and Community Services to provide advice and information on establishing and maintaining partnerships between small and medium-sized companies and community groups
- *Giving Australia: Research on Philanthropy in Australia* (2005)
- annual Prime Minister's Awards for Excellence in Community Business Partnerships.<sup>284</sup>

### 5.5.2 Other initiatives

The Australian Government has initiated a number of voluntary arrangements with industry participants and others to respond to environmental and social concerns. They include the:

- Greenhouse Challenge, which focuses on reducing greenhouse gas emissions<sup>285</sup>
- Eco-efficiency Agreements, aimed at promoting eco-efficiency in industry<sup>286</sup>

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<sup>284</sup> **Other awards.** 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.

<sup>285</sup> **Greenhouse Challenge.** Refer to the Australian Greenhouse Office, *About the Greenhouse Challenge*.

<sup>286</sup> **Eco-efficiency agreements.** Refer to the Department of the Environment and Heritage, *Eco-Efficiency Agreements*.

- National Packaging Covenant, designed to reduce packaging and other waste<sup>287</sup>
- Business Roundtable on Sustainable Development, which provides advice to the Government on ways to increase the uptake of sustainable business practices in Australia.<sup>288</sup>

There are also some relevant initiatives at other levels of government.<sup>289</sup>

## 5.6 Government initiatives

### 5.6.1 Australian initiatives

#### *Legislative provisions*

The Corporations Act includes a provision that requires issuers of certain financial products to indicate whether they have taken

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<sup>287</sup> **National Packaging Covenant.** Refer to the Department of the Environment and Heritage, *National Packaging Covenant*.

<sup>288</sup> **Business Roundtable.** The Business Roundtable, comprising CEOs or Chairs of significant companies, was established in 2003.

<sup>289</sup> **Initiatives at other levels of government.** The Ethical Investment Association in Australia operates a certification program for SRI investments, 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.

The New South Wales Department of Environment and Conservation and the CSIRO have also developed a system for business-community partnerships.

The *Environment Protection (Resource Efficiency) Act 2002* (Vic) gives companies the option of entering into voluntary covenants to decrease the ecological impact of their activities and increase their resource efficiency.

*The Victorian Government's Ethical Purchasing Policy: Supporting Fair and Safe Workplaces* (Department of Treasury and Finance, December 2003) requires suppliers of goods and services to the Victorian Government to satisfy various employment and other standards.

See further J McConvill & 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.

environmental and social considerations into account in their investment decisions relevant to the product.<sup>290</sup>

The *Energy Efficiency Opportunities Act 2006* is designed to encourage large energy-using companies to improve their energy efficiency by improving the identification, evaluation and implementation of cost-effective energy saving opportunities.

### *Legislative rationalisation*

The Council of Australian Governments (COAG) has agreed on legislation to introduce a uniform and consistent framework for mandatory reporting of greenhouse gas emissions and energy use by industry, designed to meet the current and prospective reporting needs of government, business and the public.

### *International agreements*

In accordance with the OECD *Guidelines for Multinational Enterprises*, the Australian Government established a National Contact Point to handle enquiries about, and otherwise promote, those guidelines.<sup>291</sup>

### *Promotion by government agencies of responsible practices*

Australian Government departments have been involved in developing methodologies to assist private sector entities that choose to adopt the GRI reporting principles.<sup>292</sup> They also publish

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<sup>290</sup> **Disclosure of consideration of environmental and social factors.** Paragraph 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, if it is the case, that they do not take these standards and considerations into account (Corporations Regulations reg 7.9.14C).

<sup>291</sup> **Contact point.** 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. It had a role in the *Agreed outcomes of mediation meeting* (April 2006) concerning the role of a UK-controlled multinational company in the provision of immigration detention services.

<sup>292</sup> **Reporting methodologies.** See the Department of the Environment and Heritage report, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (June 2003), Department of Family and Community Services *Triple Bottom Line Reporting in Australia: A Guide to Reporting against Social Indicators*, Draft in Discussion, July 2004.

information on the state of the environment<sup>293</sup> and have sponsored related research and information documents.<sup>294</sup> Another initiative involves management of workforce diversity in the private as well as public sectors and its implications for a socially responsible entity.<sup>295</sup>

### *Implementation of sustainability principles by agencies*

Australian Government departments and other agencies have for some years been encouraged to develop and implement environmental management systems (EMS) to the ISO 14001 standard, with the Department of the Environment and Heritage to publish this EMS information on its 'Sustainability in Government' website.

An Australian National Audit Office report indicated that, where government agencies had implemented an EMS, there was 'a significantly better environmental performance'.<sup>296</sup> However, ANAO also reported that levels of EMS use and other sustainability practices within government agencies fell short of best outcomes and that 'sustainable development has not, as yet, been fully integrated into Australian Government operations'.<sup>297</sup>

### *Preparation of sustainability reports by agencies*

Australian Government agencies are required to 'report on the effect of their actions on the environment and identify any measures to minimise the impact of those actions on the environment'.<sup>298</sup> The ANAO report indicated a low rate of such reporting by government agencies in regard to their procurement actions, but noted that

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<sup>293</sup> **Environmental information.** The National Pollutant Inventory, operating through the Department of the Environment and Heritage, provides access to information on the types and amounts of pollutants being emitted.

<sup>294</sup> **Research and information.** For example, *Corporate Sustainability—an Investor Perspective* (2003) (the Mays report) and *ESD Design Guide: Edition 2* (February 2006), both published by the Department of the Environment and Heritage.

<sup>295</sup> **Workplace diversity.** *Diversity Australia*, administered through the Department of Immigration and Multicultural and Indigenous Affairs, complements private sector initiatives in this area including *Diversity Council Australia*, established by the Australian Chamber of Commerce and Industry and the Business Council of Australia.

<sup>296</sup> **Source.** Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement* (December 2005) at 18.

<sup>297</sup> **Source.** id at 24.

<sup>298</sup> **Reporting obligation.** *Environment Protection and Biodiversity Conservation Act 1999* s 516A.

‘reporting on environmental performance is likely to improve in some Australian Government bodies in the future with 11 respondents indicating that they were planning a triple bottom line report within the next three years’.<sup>299</sup>

## 5.6.2 Initiatives in other countries

Steps taken in other countries include the setting up in the United Kingdom and France of ministries to promote responsible corporate conduct.<sup>300</sup> The UK policy framework in this area comprises legislative<sup>301</sup> and fiscal<sup>302</sup> measures, funding of research,<sup>303</sup> fostering collaboration and partnerships with various private enterprise sectors to develop programs<sup>304</sup> and strategies,<sup>305</sup> establishment of a Corporate Social Responsibility Academy, adoption of sustainable procurement policy practices in government, and undertaking a range of awareness raising activities. In March 2005, the UK Government published *Securing the Future—the UK Government Sustainable Development Strategy*, which set out broad policy goals on this area through to 2020.<sup>306</sup>

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<sup>299</sup> **Source.** Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement* (December 2005) at 18.

<sup>300</sup> **UK Minister for Corporate Social Responsibility.** The UK portfolio for corporate social responsibility is within the Department of Trade and Industry.

<sup>301</sup> **UK legislative initiatives.** Refer Sections 3.9.2 and 4.7.3 of this report.

<sup>302</sup> **Fiscal measures.** 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.

<sup>303</sup> **Research.** For instance, 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.

<sup>304</sup> **Collaboration and partnerships.** For instance, 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.

The UK Department of Trade and Industry also supported the SIGMA project, which is a partnership between the British Standards Institution, Forum for the Future (a sustainability charity and policy organization) and AccountAbility.

<sup>305</sup> **Brokering partnerships.** A ‘business broker’ program has been developed to support ‘local strategic partnerships’ between public sector organizations, businesses and community groups.

<sup>306</sup> **UK Government strategy.** 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’.

The Canadian Government has established a website, Strategis, to assist companies and other interested parties in the exchange of information and ideas, including in relation to corporate social responsibility. Industry Canada promotes sustainability principles through the provision of information.<sup>307</sup>

The US Environmental Protection Agency administers a voluntary National Environmental Performance Track program, which calls on corporate and other participants to go beyond regulatory compliance and make additional commitments to benefit the environment, with internal systems to manage these environmental programs.<sup>308</sup>

## 5.7 PJC Report

The Parliamentary Joint Committee on Corporations and Financial Services included recommendations relevant to the encouragement of responsible business and investment practices.<sup>309</sup>

## 5.8 Views in submissions

The Advisory Committee received a number of suggestions on possible ways to encourage the adoption of responsible business practices by Australian companies. The submissions on this topic are summarised below, with a more detailed version of that summary set out in *Summary of submissions*, available at [www.camac.gov.au](http://www.camac.gov.au)

### 5.8.1 Information and encouragement

Some respondents suggested that government officials could make information on social and environmental matters publicly available, for instance on a website, or incorporate relevant information in advice they give to industry. It was suggested that trade officials

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<sup>307</sup> **Industry Canada publications.** Refer *Corporate Social Responsibility: An Implementation Guide for Canadian Business* (2006).

<sup>308</sup> **US Performance Track.** The program was commenced in 2000 and has over 400 members. Participants make commitments in relation to energy and water use, greenhouse gas emissions, use of chemicals, waste generation and land conservation.

<sup>309</sup> **PJC report.** *Corporate responsibility: managing risk and creating value* (June 2006). Relevant recommendations of the Committee are at Recommendations 4, 6, 7, 9, 13 and 15–29 and those of the Labor members are at Recommendations 1-3, 6-9 and 13 of the supplementary report.

should include this information in trade, development and investment advice.

Others suggested that government should encourage discussion of social and environmental issues and facilitate environmental partnerships between government and industry or between private sector bodies. It was also suggested that government should promote uniform guidelines for sustainable business practice or encourage participation in existing indices. More government involvement in social and environmental awards was also suggested.

### **5.8.2 Use of industry associations to promote sustainability**

It was suggested that governments could reach agreements with industry to implement good social and environmental practices, or encourage industry associations to develop social and environmental measures.

Another submission said that legislative backing should be given to co-regulation or 'enforced self-regulation', in order to give the force of law to standards and codes of behaviour developed by industry groups.

### **5.8.3 Government policy**

#### *Co-ordination and leadership*

Some respondents favoured the development of a detailed policy framework for the promotion of social and environmental issues. One suggestion was to co-ordinate the government approach to this area through the appointment of a dedicated minister or commissioner.

It was argued in some submissions that the Government should encourage corporate responsibility and sustainability by requiring its departments to meet relevant standards and report on social and environmental aspects of their activities. Reference was made in this context to a report by the US Government Accountability Office in August 2005.

### ***Dealings with business***

It was suggested that government could specify relevant social and environmental aspects as criteria for selection of tenderers or award of procurement contracts.

### ***Research and education***

Some respondents proposed government investment in, or publication of, research into the contribution of social responsibility to corporate success. Others favoured government participation in or support for educational initiatives directed to sustainability.

#### **5.8.4 Fiscal measures and market incentives**

It was suggested that the Government should initiate an inquiry into environmental and social taxation, with a view to identifying and quantifying perverse subsidies at federal and state levels, shifting taxation from desirable activities to undesirable activities and evaluating options for embedding incentives for socially responsible behaviour into taxation policy. Other measures suggested in submissions were emissions trading to give sustainable practice a market value, imposition of fees on unsustainable practices and the tying of grants and subsidies, loan guarantees and export finance to desirable practices.

#### **5.8.5 Certification**

Reference was made in submissions to factors allegedly undermining the credibility of privately compiled indices, including bias and conflict of interest. There was some support for government intervention to guarantee the credibility of indices and/or benchmarks. One submission argued that there was limited access to information contained in private indices. Some respondents favoured the establishment by government of its own performance indicators or benchmarks.

It was suggested that the Government should support the Australian Standard on Corporate Social Responsibility (AS 8003-2003) or a comparable international standard, and that the Government could adopt voluntary social labelling, based on meeting specified criteria.

Some submissions supported greater involvement by government in developing support for existing measures such as the Global Reporting Initiative and the Corporate Responsibility Index.

### 5.8.6 Regulation

A number of respondents put forward proposals that would require legislative change. These included:

- a requirement for all public companies and large proprietary companies to adopt and make available a code of conduct or explain why not
- to permit or require companies to recover performance-based executive compensation awarded during a period in which full financial provision is not made for a company's environmental and social liabilities
- to give community organizations and corporate employers protection from liability, and clarify their occupational health and safety obligations, where employees spend some of their company time undertaking voluntary work with community organizations.

One respondent proposed the development by the ASX of a market index that measures the performance of companies against the *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003).

## 5.9 Advisory Committee view

Governments are able to influence corporate behaviour in a number of ways. They have an important role in providing public policy settings that shape the environment in which companies carry on their activities. Governments can also lead by example in their own activities. They may be able to contribute through advocacy or facilitation to the shaping of community viewpoints. In the end, however, it is for companies themselves and those who run them to take responsibility for what they do and the decisions they take in the shifting marketplace of law, consumer preferences, employee

views, investor sentiments, community attitudes and other pressures under which they operate.

### **Boundaries for corporate behaviour**

Governments lay down critical boundaries for behaviour by corporations, just as they do for individuals and other bodies. Laws enacted to advance or protect public policy goals and other values, or to respond to particular problems as they arise, constrain and shape corporate behaviour. Examples include laws enacted in the interests of health and safety, the environment, employees, competition and consumer protection, human rights and the community in general. It is for governments to decide where the pursuit of a particular goal or the protection of a specific interest calls for intervention.

### **Accountability framework for corporations**

The Government also has a key role—through corporations law and regulatory processes—in providing the framework for the governance of corporations and accountability by directors and corporate officers. The Government is able to contribute to the promotion of responsible corporate conduct—whether in relation to investors, employees, customers, the environment or the community—through the maintenance and strengthening of the legislative and regulatory framework that is designed to promote transparency and accountability in the way companies are governed. Disclosure and reporting requirements are an important element of this governance, as discussed in the previous chapter.

### **Corporate compliance**

Agencies including the Australian Securities and Investments Commission, the Australian Competition and Consumer Commission and the Australian Prudential Regulatory Authority play a significant day-to-day role in administering laws applicable to business conduct. They spell out or resolve detailed regulatory issues and carry out educational programs as well as undertaking investigation and enforcement activities. These bodies are able to influence corporate conduct and enforce legal standards in their respective areas.

Reference should also be made to various initiatives being undertaken with a view to rationalising the network of Commonwealth, State and Territory laws that impinge on corporate conduct in particular areas. Efforts of this kind to achieve uniform and consistent laws, whether in relation to the environment or other areas, help to promote effective enforcement and compliance.<sup>310</sup>

### Other possible initiatives

The Advisory Committee's starting point for consideration of any further government initiatives is the proposition that, in general, it is in a company's own interests, in terms of enhancing its value or managing its risks over time, to take into account the environmental and social context in which it operates and the impact of its activities. The Committee's views on this 'business case' for social responsibility are set out in Section 2.5.

The Committee does not see a need for government to provide across-the-board fiscal or other incentives for companies to operate in a socially responsible manner. Nor should government seek to compel companies to adopt a particular managerial approach.

Reference has already been made to a plethora of initiatives—many of them valuable—by which companies, industry groups, NGOs and others, sometimes in conjunction with governments, are working to develop corporate conduct guidelines or reporting standards in areas of concern, particularly in relation to environmental and other social issues. These include initiatives by the Government, often in combination with industry, to encourage responsible business practices, including through the Prime Minister's Community Business Partnership (outlined in Sections 5.5 and 5.6), as well as industry, market and educational initiatives (outlined in Sections 5.2, 5.3 and 5.4).

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<sup>310</sup> **Proposals for uniformity.** The Advisory Committee report *Personal liability for corporate fault* (September 2006) proposes a more consistent, as well as a more principled, approach to personal liability for corporate fault across Commonwealth, State and Territory jurisdictions. The report argues that a more standardised approach in this area would reduce complexity and aid understanding. It would assist efforts to promote effective corporate compliance and risk management, while providing more certainty and predictability for the individuals concerned. The report is available at [www.camac.gov.au](http://www.camac.gov.au)

There is scope for additional ‘light touch’ measures by government, helping corporate and other participants where the opportunity arises, without constraining energy and initiative in the community marketplace. The corporate sector’s own appreciation of the relevance of responsible practices to business success is likely to be the key determinant of change. Also, care should be taken not to lose sight of the fact that the role of companies is to carry out their business or other objectives, subject to legal and other constraints. While the community may look to companies to behave responsibly and to contribute in ways relevant to their business, they should not be expected to bear a general fiduciary duty to solve societal problems.

### *Policy coherence and integration*

A consistent ‘whole of government’ approach to the development and implementation of policies and administrative arrangements that have implications for corporate conduct and practices is desirable. Apart from the key corporate and business regulatory bodies, a number of departments and other agencies have policies or programs that refer to responsible corporate behaviour. The co-ordination of relevant activities and programs should be pursued as far as possible. Likewise, appropriate opportunity should be taken to promote consistency of approach in legislation at Commonwealth, State and Territory levels that has a bearing on responsible business practices.

### *Leadership by example*

The Government is able to set an example to the private sector through the governance and disclosure standards and practices of public agencies, as well as by sharing public sector experience. Relevant areas include the application of environmental and other performance and disclosure standards to departments and other agencies and assessing, and reporting on, the workability and effectiveness of those standards. There are already some initiatives in this regard.

### *Promotion*

There may be some scope for government to assist companies, investors and other interested parties to understand better the range of issues relating to corporate responsibility through collating and disseminating information and, if necessary, commissioning relevant

research or other material. There may be opportunities to assist small and medium companies in particular in this way.

### *Encouraging participation*

Where relevant work is undertaken at an inter-governmental level, such as at the OECD or the UN, there is clearly scope for the Government to participate and through consultation to draw on the experience of the corporate sector and others with an interest.

Participation by Australian industry and other groups in the development of voluntary industry codes or other guidelines at the international level is also to be encouraged. There may be scope to encourage continuing Australian participation in these processes through the provision of information or facilities in appropriate cases or help in co-ordinating private sector engagement.

## Appendix      List of respondents

- 1      Tom Bostock
- 2      Shann Turnbull
- 3      Australian Shareholders' Association
- 4      Group of 100
- 5      Business Roundtable on Sustainable Development
- 6      David Wishart
- 7      Ben Neville
- 8      Therese Wilson
- 9      Lindsay Byrnes
- 10     Brotherhood of St Laurence
- 11     Human Rights Law Resource Centre
- 12     Professor Bryan Horrigan
- 13     Tabitha Ponnambalam
- 14     Justine Nolan, Australian Human Rights Centre
- 15     Environment Institute of Australia & New Zealand
- 16     Insurance Australia Group
- 17     Finance Sector Union of Australia
- 18     James Hazelton
- 19     Futureye
- 20     Australian Society of Archivists
- 21     Corporate Law & Accountability Research Group, Monash University

- 22 Public Interest Law Clearing House (Vic)
- 23 EcoSTEPS
- 24 Stephen Epstein SC
- 25 Marina Nehme
- 26 Chartered Secretaries Australia
- 27 Tim Heesh
- 28 Law Council of Australia (Insolvency & Reconstruction Law Committee)
- 29 Ernst & Young
- 30 Institute of Chartered Accountants in Australia
- 31 Anthony Papamatheos
- 32 Credit Union Industry Association
- 33 St James Ethics Centre
- 34 Australian Conservation Foundation
- 35 Dr Jean Raar, Deakin University
- 36 UniSuper
- 37 Australian Centre for Corporate Social Responsibility
- 38 Hermes Pensions Management Ltd, UK
- 39 Lend Lease Corporation
- 40 ANZ Banking Group
- 41 Juliette Overland, Macquarie University
- 42 QBE Insurance Group
- 43 Australian Institute of Company Directors
- 44 NSW Young Lawyers
- 45 National Australia Bank
- 46 Coles Myer Ltd

- 47      Reputex Ratings & Research Services
- 48      Chamber of Commerce and Industry, WA
- 49      Australian Bankers' Association
- 50      Dr John Howe, University of Melbourne
- 51      Henry Bosch AO
- 52      Christopher Symes, Flinders University
- 53      NSW Attorney-General
- 54      Amnesty International Australia
- 55      Australian Securities and Investments Commission
- 56      CPA Australia
- 57      Business Council of Australia
- 58      AMP Capital Investors
- 59      Ethical Investment Association
- 60      Law Council of Australia (Corporations Committee)
- 61      John Green