



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

# **THE SOCIAL RESPONSIBILITY OF CORPORATIONS**

## **Summary of submissions**

**December**  
**2006**

Corporations and Markets **Advisory**  
**Committee**

**The social responsibility  
of corporations**

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# 1 Duties of directors

*This chapter summarises the range of views in submissions on the adequacy of the current law of directors' duties in regard to including social and environmental considerations in corporate decision-making and outlines a range of proposals by various respondents to amend that law.*

*An abbreviated version of this summary is found in Section 3.11 of the Advisory Committee report **The social responsibility of corporations** (December 2006).*

## 1.1 Terms of reference

The terms of reference include:

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?

## 1.2 Current law

The submissions to the Advisory Committee on these two questions in the terms of reference generally agreed with the proposition, as set out in Chapter 3 of the report, 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 at least choose to take into account a range of factors external to the shareholders if this benefits the shareholders collectively. For instance:

Current statutory obligations and industry standards encourage directors to have regard for the interests of

shareholders and other stakeholders, where it is determined that such interests are also in the interests of the company. Corporate decision makers are not constrained by the existing framework. The law does not impede directors or companies from taking account of the interests of other stakeholders.<sup>1</sup>

The *Corporations Act* and relevant common law principles do not directly prevent corporate officers from taking into account the interests of stakeholders. While there is no direct legal obligation in company law on directors to take the interests of stakeholders into account, this does not preclude directors from choosing to do so.<sup>2</sup>

CCI does not believe there is evidence that directors feel that their duties prevent them from taking into account the interests of stakeholders other than shareholders, to the extent that those interests are relevant to the company and its shareholders.<sup>3</sup>

Beyond that, some submissions adopted the voluntary ‘enlightened self-interest’ business approach and argued against any need for legislative clarification or obligation in regard to directors’ duties, while some other submissions argued for various legislative changes, including to oblige directors to take certain stakeholder interests or environmental/societal principles into account, or alternatively to give them greater protection if they so do.

## 1.3 The business approach

### 1.3.1 General principles

Sections 2.3.3 and 2.4.1 of the Advisory Committee report outline the business approach to corporate social responsibility. In essence:

- 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 articulate minimum

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<sup>1</sup> ABA (Submission 49).

<sup>2</sup> NSW Young Lawyers (Submission 44).

<sup>3</sup> Chamber of Commerce and Industry of WA (Submission 48).

standards of conduct and enshrine 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 is a matter for the commercial judgment of directors what stakeholder interests to consider in particular situations and how to manage, balance or prioritise them.

The business approach challenges any view that directors' duties can only be fulfilled by pursuing maximum profits and immediate returns to shareholders regardless of the societal consequences, or that the interests of shareholders and other stakeholders are mutually exclusive and that the wealth of shareholders can only be maximised by sacrificing the interests of other stakeholders.

### **1.3.2 Submissions supporting the general principles**

Various respondents supported these general principles underlying the business approach to corporate social responsibility. For instance:

A company's paramount obligation is to its shareholders—but that does not mean that companies must ignore the needs of other groups of stakeholders. The two are not mutually exclusive. Increasingly companies are recognising that the long-term viability of a company (and therefore shareholder interests) is protected by recognising other stakeholder interests that impact their operations. ... there are limits to the extent that corporations can and should have regard to

interests other than those of shareholders. The litmus test for any activity or responsibility is whether the performance of that activity or responsibility can reasonably be seen to be contributing to the growth of shareholder value.<sup>4</sup>

Australian boards generally operate on the basis that to be sustainable, a corporation must maintain a reputation for ethical conduct and accommodate the legitimate interests of shareholders, employees, customers, business partners, the communities affected by their operations and the environment.<sup>5</sup>

the Australian legislative environment currently provides an adequate framework to allow companies to consider broader stakeholder interests, and that in fact, it makes good business sense to do so.<sup>6</sup>

a board that operates in the best interests of the company will be mindful of its other stakeholders to ensure the continuation and evolution of the business. There appears to be no impediment to boards, management or companies reporting or focusing on their CSR efforts.<sup>7</sup>

The *Corporations Act* does not stop directors from taking into consideration the interests of different stakeholders. They can do so as long as their action does not breach the legislation. The interests of the company and the interests of the stakeholders are interdependent because a company can't function without the support of its suppliers, consumers, shareholders [etc]. Directors will be breaching their duties under the *Corporations Act* if they do not try to ensure the long term financial stability of the company. Such stability will only be reached if the directors take into consideration the interests of the relevant stakeholders.<sup>8</sup>

The primary duty of a director is to act in the best interests of the company and it is a matter for the Board to determine, when, and to what extent, stakeholder interests should be taken into account. Directors should have the ability to balance competing interests from time to time.<sup>9</sup>

the Corporations Act and the common law dealing with directors' duties allow directors appropriate flexibility to

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<sup>4</sup> BCA (Submission 57).

<sup>5</sup> AICD (Submission 43).

<sup>6</sup> National Australia Bank (Submission 45).

<sup>7</sup> ASA (Submission 3).

<sup>8</sup> M Nehme (Submission 25).

<sup>9</sup> ABA (Submission 49).

take into account a broad range of interests when they consider the interests of the company. The “principles” based approach reflected by the legislation and common law allows directors of solvent companies to take into account both necessary short term issues and the longer term, and to have regard to the circumstances of each company—its size, business and special impact on specific stakeholder groups. These laws—which have remained the same in basic principle for over the whole of the past century and longer—have allowed corporate culture to adapt with and respond to changing societal expectations, new technologies, new business methods and changing concepts of who corporate “stakeholders” are.<sup>10</sup>

Company directors are entitled to take into account the interest of stakeholders other than existing shareholders when exercising their duty to act in “the best interests of the corporation” and in certain circumstances may be obliged to do so. Acting socially responsibly is likely to result in positive publicity; public approval, endorsement and goodwill; investor confidence and demand; and resulting positive impact on the company share price. Thus it may be in the best interests of the corporation to act socially responsibly. ...Overall, directors have flexibility to consider and balance short-term and long-term considerations when exercising their powers, so long as any decision that is made is in “the best interests of the company”.<sup>11</sup>

We believe any suggestion that a corporation may ignore its social responsibilities in order to ensure shareholder returns is flawed, as the two issues are not mutually exclusive, particularly in the current corporate environment where companies are under their greatest ever level of scrutiny, both from a prudential and public perception perspective.<sup>12</sup>

The strict notion that companies operate purely in pursuit of profit maximization is a misnomer in both the practicality of modern business, and the legal framework, which affords decision-makers a realistic capacity to make positive allowance for the interests of stakeholders. Directors are obliged to act in the bona-fide interests of the company, however this does not necessarily mean they must always pursue profit maximisation or that they cannot consider the needs of other stakeholders.<sup>13</sup>

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<sup>10</sup> Law Council of Australia (Submission 60).

<sup>11</sup> J Overland (Submission 41).

<sup>12</sup> QBE Insurance Group (Submission 42).

<sup>13</sup> CPA Australia (Submission 56).

Directors are required to consider broader interests in addition to those of shareholders under their current obligations. Directors have a first duty to the interests of the company and would be derelict in their duty if they did not seek to ensure the long-term survival, financial performance and health of the company. It is only by doing so that a company will continue to grow and add value to the community in which it operates. In order to do so directors must ensure that the company continues to give appropriate recognition to the concerns and expectations of the community.<sup>14</sup>

Directors do not, in our experience, generally define their obligations narrowly, or focus on shareholder returns at the expense of all other stakeholders. Having regard to stakeholders' broader interests is vital for the long-term interests of the company and its sustainability. The exclusive pursuit of short-term returns for shareholders may turn out to be counter-productive in the longer term, thus circumstances may warrant incurring a short-term cost that benefits some stakeholders provided the directors are satisfied that this is outweighed by the long-term sustainable benefits what will ultimately flow to shareholders as a result of incurring that cost.<sup>15</sup>

We believe that the directors' duty always to act in the best interests of the shareholders means that they need to take into account the interests of other stakeholders.<sup>16</sup>

One respondent,<sup>17</sup> however, observed that:

Not all companies recognise the business case for CSR or perceive issues linked to governance, environmental, social or workplace factors as an immediate material risk to the company and its shareholders ... Research by RepuTex indicates that companies in sectors including Banking and Materials have tended to more readily adopt strategies which address key social risks and maximise associated opportunities, while other sectors such as Media, Hotels and Leisure have tended toward a compliance based approach.

There are obvious reasons for this. Industries such as Banking have been subject to significant stakeholder scrutiny stemming from a perceived lack of concern for the communities in which they operate. This has led some

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<sup>14</sup> G100 (Submission 4).

<sup>15</sup> Insurance Australia Group (Submission 16).

<sup>16</sup> Hermes (Submission 38).

<sup>17</sup> RepuTex (Submission 47).

Banks to become CSR leaders in Australian (and global) markets. Similarly companies in the Materials sector, particularly the extractive industries, have attempted to adopt a more sustainable profile following various NGO and social movement actions around issues stemming from environmental degradation and indigenous rights.

There remains some area for debate within the business approach on what acting in the best interests of the company for the purposes of s 181 may require, including how to balance short-term and longer-term considerations. According to one respondent:<sup>18</sup>

a false dichotomy has developed between the ‘best interests of the corporation’ and the interests of the company’s wider stakeholders. The current primary obligation to act in the best interests of the corporation gives directors sufficient scope to consider broader interests. Indeed, far from restricting a company’s ability to give due consideration to the interests of wider stakeholders, it could be argued that the current law already requires it ... There is a wide range of social, political and environmental pressures encouraging corporations to act responsibly and responding to these pressures is integral to the organization’s sustainability. It is doubtful whether, in light of these pressures, a director focused solely on the company’s short-term share price could successfully argue sufficient compliance with the duty to act in the best interests of the corporation.

## 1.4 Critique of the business approach

### 1.4.1 The James Hardie case

#### *NSW Attorney General*

The submission by the NSW Attorney General (Submission 53) argued that the James Hardie experience (in which, according to the submission, James Hardie’s directors claimed, at least initially, that they were unable to contribute funds to meet the liabilities of their former subsidiaries because of their duties to their shareholders) illustrated the need for some change to the current law of directors’ duties:

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<sup>18</sup> ANZ (Submission 40).

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

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

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

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

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

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

These underlying issues include the need to remove incentives for directors to act solely in the interests of shareholders. They include the need to clarify that directors' sole motivation must not be the maximisation of profit for shareholders at the expense of the interests of the

community. It must be clear that directors will fail in their duty to the company if they do not take relevant stakeholder interests into account.

### *Law Council*

The Law Council of Australia (Submission 60) made the following comments on the context of the legal issues facing the James Hardie board and how these matters went beyond directors' duties:

The directors' duties provisions of the Corporations Act and the common law do not provide inappropriate disincentives to directors who want to take account of stakeholder interests. However, actions taken by companies—for instance, representations made to the market about what conduct the company will or will not engage in—can constrain action. This is a necessary consequence of the interaction of a range of provisions of the Corporations Act, and that interaction should not be overridden by amendments to the laws dealing with directors' duties. Arguably what happened in the James Hardie case was this: having reconstructed the group and made representations to the market about the impact of that reconstruction on liability for asbestos related claims, the directors may have been constrained from acting inconsistently with those representations. This is not a directors' duties issue (although the public debate has framed it that way). Without the reconstruction of the James Hardie Group, the Committee considers that there would have been no constraint on a solvent James Hardie (incorporated in Australia) from addressing asbestos claims.

#### **1.4.2 Formulation of directors' duties**

Various respondents were concerned about the right of directors under the current law to choose what, if any, stakeholder interests to take into account in corporate decision-making. They noted that directors have no obligation under the existing law of directors' duties to consider and give effect to non-shareholder interests for their own sake. Many of these respondents used this observation as the starting point for proposing a more interventionist legislative regime in regard to directors' duties:

While directors are “permitted” to consider the interests of other stakeholders apart from shareholders, it also ‘permits’ directors to *not* consider the interests of other stakeholders ... This ‘permission’ must be revoked and substituted with a

mandate that directors *must* consider the effects of their actions upon stakeholders.<sup>19</sup>

Section 181 of the Corporations Law does not prohibit corporate social responsibility, but neither does it specifically encourage it. Companies may not necessarily interpret “good faith” and “best interests of the corporation” to consider responsibility to the wider set of stakeholders who contribute to a corporation’s wealth.<sup>20</sup>

The company has been defined in this regard to mean ‘the shareholders as a whole’ or, where a company is insolvent, the creditors. In either case, it is the financial interests of those groups- as linked to the company’s financial interests- that are regarded as relevant. This would seem to preclude an exercise of discretion by directors in favour of general social welfare, unless clear benefit to shareholders in terms of financial return can be demonstrated. Put another way, directors will potentially breach their duty to act in the best interests of shareholders if they exercise social responsibility in a manner that might impact on profits. ... It seems clear that the current legal framework and the corporate culture that flows from it actively discourage corporate directors from acting in the interests of the broader community, except where there are clear strategic benefits, in terms of profit return to shareholders, in doing so. A revision of the Corporations Act to clarify directors’ duties and the need for directors to consider the interests of a broader stakeholder group is desirable.<sup>21</sup>

The CAMAC Discussion Paper gives a strong argument as to why boards and their directors can not be obliged to favour environmental externalities or the wellbeing of third parties over their shareholders’ interests. So to the extent that CSR considerations adversely affect the financial interests of shareholders, such matters may not be seen as in the shareholders’ interest. It would appear that where the shareholders’ interests materially conflict with the broader community’s interest—then the shareholders’ interests prevail ... Against this background, the Institute’s view is that Australian corporations law should be amended to require company directors and business managers to take relevant environmental and social considerations into account in their decision-making. The Institute recognises that in some circumstances specific legislation may have advantages over more general corporations law, including

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<sup>19</sup> Ben Neville (Submission 7).

<sup>20</sup> Australian Centre for Corporate Social Responsibility (Submission 37).

<sup>21</sup> T Wilson (Submission 8).

greater certainty and better enforceability. The Institute proposes, however, that to the extent that current corporations law prevents or discourages corporate decision-makers from taking CSR considerations into account in corporate decision-making because of a conflict between the interests of shareholders and the interests of the wider community, the solution must lie in reforming corporations law.<sup>22</sup>

Section 181 of the *Corporations Act*, which requires directors to act in good faith in the best interests of the company and for a proper purpose, only permits corporations to have regard to, and act in the interests of, social, environmental and broader community interests in so far as those interests are related to, or likely to bear on, the financial interests of shareholders. ... The *Corporations Act* as currently drafted, interpreted and applied would appear to require that social and environmental interests be subverted to shareholders' financial interests to the extent of any incompatibility or inconsistency. ... In fact, where the interests of shareholders and other interests, including social and environmental interests, are divergent, it is clear that directors are required to act contrary to those latter interests.<sup>23</sup>

We note, for the sake of clarity, that under the usual interpretation of directors' duties, directors are prohibited from considering the interests of non-shareholder constituencies *except* where such consideration furthers the interests of the shareholders. The "consideration" of non-shareholder interests under this view is strictly derivative of the overriding obligation to act in the interests of the shareholders. Non-shareholders are mere instruments for the maximisation of shareholder gain.<sup>24</sup>

## 1.5 Should there be legislative change?

Various respondents argued that no legislative change to the law of directors' duties was necessary (Section 1.5.1, below). It was also argued that specific environmental or other legislation, not the Corporations Act, is the appropriate vehicle further to protect society against any real or anticipated socially harmful corporate conduct, or

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<sup>22</sup> Environmental Institute of Australia & New Zealand (Submission 15).

<sup>23</sup> Human Rights Law Resource Centre (Submission 11).

<sup>24</sup> Australian Conservation Foundation (Submission 34).

further encourage socially responsible corporate conduct (Section 1.5.2, below).

Some other respondents put forward a range of proposals to amend the statutory duties in the Corporations Act or introduce other changes to that Act related to those duties. Some of the proposals sought to increase the duties of directors and officers, while others sought to give them greater discretion or protection in their decision-making. The proposals were:

- permissive pluralism (Section 1.5.3)
- business judgment defence (Section 1.5.4)
- introduce a subjective element into s 181 (Section 1.5.5)
- replaceable rule (Section 1.5.6)
- mandatory pluralism (Section 1.5.7)
- UK Companies Act approach (Section 1.5.8)
- ethical judgment rule (Section 1.5.9)
- responding to short-termism (Section 1.5.10)
- licence to operate approach (Section 1.5.11)
- statutory elaboration of corporate decision-making framework (Section 1.5.12)
- employee representation on the board (Section 1.5.13)
- mandatory stakeholder advisory boards (Section 1.5.14)

### **1.5.1 No legislative change**

Many respondents considered that no change to the current directors' duties provisions was necessary. For instance, according to the BCA (Submission 57):

There is no evidence that company directors and officers feel constrained by their current duties from taking into account interests of stakeholders other than shareholders. Any

amendment to the Corporations Act to either, clarify the operation of the directors' duties in the Corporations Act such as an 'enabling' provision, or to make mandatory the consideration of stakeholder interests other than shareholders, is therefore considered unnecessary.

The BCA also believed that such amendments could be counterproductive. For example, it was argued that:

an 'enabling' provision may be counterproductive for a number of reasons, including:

- over time, an 'enabling' provision can become interpreted such that it becomes effectively mandatory. An amendment to the Corporations Act may give the impression that there is a problem with the operation of the directors' duties in the Corporations Act as they currently stand. This may lead to judicial interpretation over time that changes the 'enabling' provision to in fact become mandatory.
- over time, circumstances can change such that issues that were not considered important in the past, may become more important in hindsight. An 'enabling' provision can run the risk of creating a legal obligation for Boards to have addressed such issues at a Board level. Given that stakeholders are such a potentially wide class (and indeed, very difficult to define or identify) this potentially raises a significant due diligence issue for Boards, to show that they identified and considered a very wide class of potential stakeholder.
- such an amendment runs the risk of providing rogue directors or officers with a loop-hole to undertake activities that might not be in the best interests of the company. For example, a particularly charismatic and dominant director may use shareholders and investors money to pursue their own personal interests through philanthropic or other activities, at the expense of the company.

Accordingly, the BCA argued that amendments to the directors' duties in the Corporations Act were unnecessary at best and counterproductive at worst.

Various other respondents also argued for no change to the directors' duties provisions. For instance:

The present thrust and structure of the Corporations Act, and the wider legal framework within which business operates cannot be regarded as either an impediment or a disincentive to business being conducted in a socially responsible manner.<sup>25</sup>

UniSuper believes that the Corporations Act, in conjunction with Australian Federal, State and Local laws and specific legislation such as the Environmental Practices Act and Occupational Health and Safety Act, enables directors to account for a wide range of interests, including Corporate Social Responsibility. As such, UniSuper feels that there is sufficient protection for specific classes of stakeholders and the broader community under current legislation, and that the Corporations Act need not be revised.<sup>26</sup>

Maintaining the status quo would thus avoid higher risks of litigation against companies and their directors, and ensure that many highly experienced competent directors did not withdraw from the available pool due to potential expectations and liability being too high. It would also ensure that Directors' & Officers liability insurance has the best chance of being both attainable and affordable.<sup>27</sup>

CUIA strongly opposes any provision in the *Corporations Act 2001* that require a credit union or its directors to have particular regard to the interests of other parties before the interests of their members (who are their shareholders). This is not a rejection of CSR, which is inherent to the credit union sector, but a reflection of the appropriate allocation of corporate duties, responsibilities and liabilities and the efficient use of limited resources.<sup>28</sup>

It is not appropriate to address every current concern about the ethics of conduct by individuals or corporations by change to laws. The market has demonstrated its willingness to act against companies who move beyond ethical expectations. The thought that there should be a legislative solution to each lapse of "moral" conduct leads to over-regulation.<sup>29</sup>

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<sup>25</sup> CPA Australia (Submission 56).

<sup>26</sup> UniSuper (Submission 36).

<sup>27</sup> Insurance Australia Group (Submission 16).

<sup>28</sup> Credit Union Industry Association (Submission 32).

<sup>29</sup> AICD (Submission 43).

In a dynamic market environment, balancing competing interests, businesses must have the flexibility to voluntarily determine their own practice of CSR rather than comply with a one-size fits all approach.<sup>30</sup>

ASIC (Submission 55) also considered that no change to the current law was required:

corporations law gives directors considerable freedom to consider the interests of a range of stakeholders, provided the directors' over-riding purpose is to act in the interests of the corporation as a whole. In ASIC's view this aspect of the law is clear and, assuming the Government wishes to retain the current policy settings, the Act does not require amendment.

One respondent<sup>31</sup> argued that any dilution or obscuring of the Corporations Act requirement that directors exercise their powers in the best interests of the corporation would be inconsistent with the general trend internationally in corporate governance:

The 2004 OECD Principles of Corporate Governance prescribe as the primary principle for the responsibility of boards of directors that:

*“Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.”*

The Statement on Global Corporate Governance Principles of the International Corporate Governance Network, expounding the OECD Principles, as revised on 8 July 2005, commences:

“1. **CORPORATE OBJECTIVE —  
SHAREHOLDER RETURNS**

*1.1 **Optimising Return To Shareholders.** The overriding objective of the corporation should be to optimise over time the return to its shareholders. Corporate governance practices should focus board attention on this objective. In particular, the company should strive to excel in comparison with the specific equity sector peer group benchmark. Where other considerations*

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<sup>30</sup> Lend Lease (Submission 39).

<sup>31</sup> Stephen Epstein SC (Submission 24).

*affect this objective, they should be clearly stated and disclosed.*

**1.2 Long Term Prosperity Of The Business.** *To achieve this objective, the board should develop and implement a strategy for the corporation which improves the equity value over the long term.”*

The current provisions of the Corporations Act are consistent with the application of those objectives to Australian corporations. No change to the Corporations Act in this respect is necessary or desirable.

Another respondent<sup>32</sup> expressed more general philosophical concerns about legislative prescription in this area:

We believe that the use of legislation, regulation and surveillance as the principal means for protecting the interests of stakeholders other than shareholders is misguided. Our concerns are twofold. First, an over-reliance on such an approach is largely ineffective because it invites a negative culture of compliance characterised by indifference to the principles that inform the legislation or regulations. In these circumstances, corporations become adept at playing a game of ‘regulatory arbitrage’—across jurisdictions and through the exploitation of loopholes.

Second, we believe that an over-reliance on regulation and surveillance can inadvertently weaken the ethical sinews of society. When people comply by merely ‘ticking the box’, then they are absolved (or absolve themselves) of any responsibility for choosing to act in a manner that is right and good. One of the unintended consequences of a system designed to ensure that people cannot choose to do what is wrong is that they can no longer choose to do what is right. They no longer choose at all—they merely comply. This weakening of the ethical sinews of society generates considerable, latent risk. If for any reason the regulations fail, the lack of underlying resilience can lead to a broad failure of responsible conduct.

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<sup>32</sup> St James Ethics Centre (Submission 33).

## 1.5.2 Role of the Corporations Act

Various respondents considered that specific environmental or other legislation, not the Corporations Act, was the appropriate vehicle further to protect society against any real or anticipated socially harmful corporate conduct, or further encourage socially responsible corporate conduct.

In this context, it was argued that:

- focusing on specific legislation, rather than the Corporations Act, to introduce any necessary change enables a consistent approach to particular environmental or social issues, applicable to companies, partnerships, trusts, unincorporated entities, sole traders and other individuals. The Corporations Act does not, and cannot, have this width of coverage:

The range of specific laws dealing with environmental, social and economic regulation (which generally apply to all kinds of business enterprise, and whether or not incorporated in Australia) are a better mechanism for creating specific obligations to wider stakeholder groups in Australia than imposing generalised duties under the Corporations Act.<sup>33</sup>

Efforts to encourage or prohibit specific social or environmental practices should be addressed through relevant legislation including environmental and labour laws. The Corporations law already imposes an obligation on companies to comply with any extraneous laws [for instance, s 185] and this interaction has already compelled improved standards of conduct in environmental protection.<sup>34</sup>

- the Corporations Act uses the structure of specific duties, requirements, procedures and prohibitions. The Act may set out the general goals of particular procedures (for instance s 435A in regard to voluntary administrations and s 602 in regard to takeovers), but beyond that it tends to avoid expressions of general sentiment extolling the virtues of particular forms of behaviour. In the area of directors' duties, for instance, the Act

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<sup>33</sup> AICD (Submission 43). Similar views were expressed by other respondents, including ABA (Submission 49).

<sup>34</sup> CPA Australia (Submission 56).

should contain enforceable duties, rather than vague or general exhortations to behave responsibly.<sup>35</sup>

Another observation was that any legislative expansion of directors' duties would have to be reconciled with the need to ensure that clear lines of board accountability to shareholders are maintained. The common denominator in much of the corporate governance law reform since the 1980s, as reflected in the Corporations Act, has been to strengthen this duty of accountability of directors to shareholders in various ways. Should directors be required, or expressly permitted, to take other interests into account, then the problem arises of how to ensure that the accountability of directors to shareholders, and the ability of regulators to enforce those duties, are not diluted. Boards that are ostensibly accountable to everyone may finish up being answerable to no-one. For instance:

Over the last two decades a great deal of progress has been made in developing corporate governance structures and procedures which reduce the likelihood and scope for the abuse of unaccountable power. A vital element of corporate governance is the recognition that managements are accountable to boards and boards are accountable to shareholders. For accountability to be effective there have to be criteria by which performance can be measured which are clear, simple and straight forward.

It is vital that the Corporations Act preserves the clear accountability of boards to some external entity able to hold them to account. Were directors required to take other interests into account their accountability to shareholders would be diluted and it would be difficult, if not impossible, to show that they were not acting properly.

Stakeholders and the general community are so diverse that they cannot perform this function. Clear responsibility to shareholders for the prosperity of the company in perpetuity is the essential basis of accountability and legislators would be very unwise to tamper with it.<sup>36</sup>

Some of the concerns about the workability of corporate social responsibility type provisions in the Corporations Act were reflected in the following comments by one respondent:<sup>37</sup>

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<sup>35</sup> For instance, ASIC (Submission 55), Stephen Epstein SC (Submission 24).

<sup>36</sup> H Bosch (Submission 51).

<sup>37</sup> Stephen Epstein SC (Submission 24).

Some people might perhaps think that the insertion into the Corporations Act of a sentiment exhorting the virtues of corporate social responsibility will, in itself, motivate action in that direction. However, in practical experience, company directors are not avid readers of the Corporations Act. It would be naïve in the extreme to think that the mere expression of the sentiment in the Act could be conducive to changed behaviour.

If the Corporations Act is to be amended with a view to facilitating the goal of corporate social responsibility, more is necessary than words of exhortation. The creation of legally enforceable rights and obligations would be necessary.

If the interests of stakeholders, other than shareholders, are to obtain legal recognition in the Act, then it would be necessary for the Act to lay down procedures whereby such stakeholders can enforce their rights against the company.

More generalised corporate social responsibility issues, such as environmental issues, would not have any obvious stakeholder representative, so that there would presumably need to be standing given to public interest groups to litigate the making of corporate decisions relevant to such issues.

Another respondent<sup>38</sup> commented that:

Creating a legal requirement to take into account other stakeholder interests creates a risk that the legitimate decisions of the Board and management of the company may be challenged by small minority interests that are not in the interests of the company or its primary responsibility. A minority interest may not be in the best interests of the majority of stakeholders. There is a risk that directors will be distracted by vexatious litigation instead of concentrating on managing the company in the interests for which they have been given permission to do so by their owners. A statutory obligation may in fact narrow the focus of the Board and management of the company creating inefficiencies in company operation and management; ultimately to the detriment of shareholders and other stakeholders.

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<sup>38</sup> ABA (Submission 49).

Another respondent<sup>39</sup> commented that:

If business is obliged to further the interests of the community, society, government and environment as well as owners, a range of questions arise:

- which groups and interests are entitled to consideration in how the business is run?
- by what means is that consideration to be put into practice?
- are all identified stakeholders given equal weight?
- how are inevitable conflicts between the interests of stakeholders to be resolved?
- how are new and changing interests to be incorporated into the business plan?

Even if these questions of entitlement can be resolved, harder problems of accountability remain.

Accountability requires a right to information, authority (the right to issue instructions) and sanctions (the right to impose penalties if those instructions are not carried out). In a typical corporation, directors are accountable to shareholders, while employees and other agents are accountable, through managers, to directors.

If shareholder value were no longer the key objective of management, a new structure of accountability would be needed to determine which interests are entitled to influence how the business is run, who is to decide when that entitlement has been breached, what sanctions are to apply, and to whom.

Such a structure would not be compatible with shareholders' rights to buy and sell shares and to sack directors. For as long as those rights exist, boards will accord special priority to shareholders' interests. Giving other stakeholders real influence over how a corporation operates would therefore require an entirely new framework of corporate accountability and sanctions.

ASIC (Submission 55) expressed particular concern about the enforcement consequences of any amendment to the Corporations

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<sup>39</sup> Chamber of Commerce and Industry of WA (Submission 48).

Act to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions. This could affect ASIC's ability successfully to enforce the Act:

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 resource of corporations; or
- establish an appropriate hierarchy of stakeholders' interests to resolve conflicting stakeholder claims on the attention and resources of corporations.

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.

### 1.5.3 Permissive pluralism

#### *Support*

There was some support for a provision (possibly in the form of 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.

One respondent<sup>40</sup> argued that the Corporations Act is unclear regarding the extent to which directors may take into account the interests of other stakeholders. At a very minimum, s 181 should be

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<sup>40</sup> Ethical Investment Association (Submission 59). The Finance Sector Union of Australia (Submission 17) also argued that there does not appear to be a clear view about whether the current regime under the Corporations Law permits directors to consider issues wider than the financial performance and future of the company itself. That respondent argued that at a minimum the law should be amended to clarify that directors can have regard to these broader considerations.

revised to give directors explicit permission to consider the interests of non-shareholder stakeholders, and longer-term considerations, particularly in relation to decisions that are likely to have negative environmental or social consequences:

while the current Corporations Act requirements are flexible enough to permit directors to have regard to the interests of specific classes of stakeholders and the broader community, there clearly remains an attitude among some corporate officers in Australia that the interests of the broader stakeholder community can and should be sacrificed in the interests of short-term shareholder returns. Indeed, corporate law and practice in Australia has contributed to a perception among some executives that they have a responsibility to maximise returns to shareholders through the externalisation of environmental and social costs created as a result of the firm's economic activity (for example, unsustainable environmental practices, or inequitable labour practices).

Legislative clarification that directors have the flexibility to take into account the interests of non-shareholder stakeholders should be welcomed by the business community. It will give comfort and possible legal protection to those directors who may, from time to time, wish to act in the long-term interests of the company at the expense of short-term profits.

Another submission<sup>41</sup> in favour of a permissive approach argued that:

it would be made clear that directors *may* consider the interests of employees, the environment, creditors, consumers, and other stakeholders in the normal course of company decision-making, even where this would conflict with the interests of shareholders and the shareholder profit maximisation objective. The legislation would need to provide some guidance for directors as to when stakeholder interests may be prioritised ahead of those of shareholders.

### *Oppose*

The pattern in submissions that were consistent with the business approach was to oppose any legal change to permit directors to take into account the interests of specific classes of stakeholders, extending beyond shareholders, or the broader community, in corporate decision-making.

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<sup>41</sup> Corporate Law & Accountability Research Group (Submission 21).

As one respondent argued:<sup>42</sup>

If some stakeholder groups are named in the “permission”, then the question is raised as to whether stakeholder groups who are not named may be taken into account or somehow have less priority. Further, listing stakeholder groups whose interests directors may take into account provides no guidance as to priority as between those groups or individuals in the groups (and it clearly cannot). As the law currently stands, directors are entitled to take into account a broad range of interests and to balance those interests according to circumstances.

#### 1.5.4 Business judgment defence

One proposal was to liberalise the defence to give greater protection to directors and officers (see *Liberalise the defence* in this section). In direct contrast, one respondent proposed two additional requirements on directors and officers before they came within the defence (see *Additional requirements* in this section).

##### *Liberalise the defence*

One commentator<sup>43</sup> argued that, while the current case law does permit directors and officers to consider non-shareholder stakeholder interests as part of the determination of what is in the best interests of the company for the purposes of s 181, it may be beneficial to clarify that matter in the legislation. The proposal was for a new provision in s 181 to provide a business judgment defence for a director or officer who does have regard to these external interests.

The proposed defence would apply to any director or officer who undertakes an activity:

- bona fide

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<sup>42</sup> Law Council of Australia (Submission 60).

<sup>43</sup> William Beerworth, Managing Director, Beerworth & Partners Ltd. A somewhat similar proposal has been put forward by Meredith Hellicar, chair of James Hardie Industries Ltd, that there be ‘a safe harbour for directors to be able to integrate corporate social responsibility into their decision-making without fear that they are going to be sued both personally, and as a company, by their shareholders’. B Horrigan (Submission 12) was also of the view that ‘the “business judgment” defence should be clarified to encompass due consideration of specified stakeholder interests by directors’.

- within the scope of the corporation's business
- for the corporation's business
- for the corporation's benefit.

According to the commentator:

The purpose of the amendment would be to clearly permit directors and officers to have appropriate regard to stakeholder interests without fear of being held in breach of their duties.

### *Additional requirements*

In direct contrast to the proposal to liberalise the defence, another respondent<sup>44</sup> proposed two additional requirements before directors and officers could rely on the business judgment defence, namely:

- to take long-term considerations into account (see Section 1.5.10, below)
- to consider 'community and legitimate stakeholder expectations' (see Section 1.5.11, below).

### **1.5.5 Introduce a subjective element into s 181**

One respondent<sup>45</sup> pointed out that s 181(1), as enacted in 1999, omitted the phrase (in bold italics) that was originally included in the Bill:

- (1) A director or other officer of a corporation must exercise their powers and discharge their duties:
  - (a) in good faith **in what they believe to be** in the interests of the corporation; and
  - (b) for a proper purpose.

According to that respondent:

The effect of deleting it "in what they believe to be" is to make a director's or other officer's belief as to what is

<sup>44</sup> AMP Capital Investors (Submission 58).

<sup>45</sup> T Bostock (Submission 1).

objectively in the best interests of the relevant company inevitably the subject of review in hindsight by the court. That gives rise to the fundamental problem that every act or omission amounts to a choice, whether made consciously or otherwise, between at least two courses: to act or not to act; or to choose between two or more alternative actions, each of which might be in the interests of the relevant company. The choice can be made only on a subjective basis at the time of making it. Whether the choice made was in the best interests of the company in the objective sense required by the amendment can be determined only afterwards in the light of hindsight; and even then, it would be more a matter of opinion than fact.

The respondent considered that:

if the Committee believes that the ability of company decision-makers to act in the interests of non-shareholder parties beyond the requirements of law should be clarified or enlarged, the most obviously expedient way of doing so would be to amend s 181(1) by restoring the words “in what they believe to be”.

### 1.5.6 Replaceable rule

One respondent<sup>46</sup> made the following suggestion:

Companies and stakeholders alike should be reminded that CSR can be tailored to suit the company’s circumstances by providing for it in the company’s constitution. A clause can be included in a company’s constitution permitting directors to take account of the interests of stakeholders other than shareholders, for example, ‘for any purpose that the board sees fit’. CAMAC may wish to explore the possibility of exploring the inclusion of such a provision as a replaceable rule in the *Corporations Act*. Shareholders would decide whether they wanted it, or a revised version of it, as an object in the constitution. This would involve shareholders in the debate on CSR and enhance community education on this subject. The involvement of shareholders in such discussions would also ensure that they are actively involved in the decision-making as to the importance placed on long-term interests in the corporations they invest in.

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<sup>46</sup> Chartered Secretaries Australia (Submission 26). D Wishart (Submission 6) also proposed a voluntary code of conduct in corporate constitutions.

Another proposal was for a replaceable rule to protect directors and officers if they prefer the long-term over the short-term in determining what is in the best interests of the company. This is further discussed in Section 1.5.10, below.

### 1.5.7 Mandatory pluralism

#### *Support*

Some submissions supported a provision (possibly in the form of an amendment to s 181 of the Corporations Act) expressly obliging directors to take into account the interests of specific classes of stakeholders, extending beyond shareholders, or the broader community, in corporate decision-making.

For instance, according to one respondent:<sup>47</sup>

The Corporations Act should be reformed to make the protection of human rights central to business decision-making. This would be done by inserting a new directors' duty into the Corporations Act along the following lines:

*"A director or other officer of a corporation must ensure that human rights are protected within the corporation's sphere of activity and influence."*

The precise human rights to be protected would need to be set out in clear form in a schedule to the Corporations Act. The elaboration of the rights to be protected would best be served by adapting, in a form appropriate for Australian legislation, the *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*

There would also be reporting obligations. A certification by directors that all relevant human rights issues have been considered and complied with would be required as part of companies' annual reports. A disclosure of any particular human rights risk factors associated with a company's operations should also be required.

Finally, in regard to enforcement, any individual who alleges to have suffered human rights violations in the course of a company's operations should be able to initiate proceedings

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<sup>47</sup> Amnesty International Australia (Submission 54), cf Brotherhood of St Laurence (Submission 10).

for breach of the directors' duty, either directly or through a designated authority such as ASIC. Confirmed breaches of the duty should give rise to criminal or civil penalties, depending on the nature of the breach, in line with existing penalties in the Corporations Act.

Other respondents also proposed legislative change, typically centred on some expansion of the s 181 fiduciary duties applicable to directors, in the direction of some environmental or social obligation. For instance:

The Corporations Act should provide that managers and directors should manage the organisation on behalf of shareholders, but not at the expense of other stakeholders.<sup>48</sup>

The Corporations Act should provide that it is the responsibility of the corporation, through its directors and officers to ensure at all times that it conducts its business in an ethical and sustainable manner. The Corporation shall include in its Corporate Governance provisions those core values considered necessary to uphold this principle in the conduct of its business. The Annual Report should include a narrative with key indicators demonstrating its adherence to this principle<sup>49</sup>

Section 181 of the *Corporations Act* should be amended to positively require directors to consider stakeholder interests and social, environmental and human rights concerns in the exercise of directors' duties. The *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* should be legislatively enacted in Australia.<sup>50</sup>

Section 181 of the *Corporations Act* should be amended to clarify that corporate directors, in acting in the best interests of the corporation, must take into account a range of constituencies, including employees, financial investors, shareholders, customers and suppliers, communities in which the corporation operates, and the environment.<sup>51</sup>

Section 181 should be amended to include a "Code for Corporate Citizenship". The effect of this amendment would be to require directors to continue to act in the best interest of the corporation, but only if it is "not at the expense of the

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<sup>48</sup> Ben Neville (Submission 7).

<sup>49</sup> L Byrnes (Submission 9).

<sup>50</sup> Human Rights Law Resource Centre (Submission 11).

<sup>51</sup> Australian Conservation Foundation (Submission 34).

environment, human rights, public health and safety, the dignity of employees, or the welfare of the communities in which the corporation operates”.<sup>52</sup>

One respondent<sup>53</sup> referred to superannuation factors in arguing for an obligation on directors to take stakeholder/longer-term interests into account:

In particular, there are unique issues at stake in this regard for the superannuation investment community. Long-term investors now dominate Australia’s financial marketplace with superannuation set to grow significantly in the coming decades. A growing number of superannuation investors recognise that profitability is dependant upon a company’s capacity and skills in building long-term co-operative relationships with specific classes of stakeholders—in particular staff, customers, suppliers, the environment, shareholders and the host communities in which the company operates. These superannuation investors require assurance and disclosure that a company is aware of the risks and opportunities related to these issues and that decision-making is conducted in that framework.

Another submission<sup>54</sup> argued that in certain circumstances directors should be required 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. There would be situations where shareholder interests need to be sacrificed in favour of the interests of other stakeholders:

that is, *requiring* directors to prioritise stakeholder interests over those of shareholders, where the risk of stakeholder interests suffering adverse treatment is particularly heightened—primarily, when the company is encountering financial difficulty and may, or has, become insolvent.

The relevant stakeholder individual(s) or group(s) could be required to show that its/their interests were “substantially prejudiced” by the directors’ actions or proposed actions, in order to show a breach of this aspect of the new directors’ duties.

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<sup>52</sup> Submission by Robert Hinkley to the Parliamentary Joint Committee Inquiry, referred to by the NSW Young Lawyers (Submission 44).

<sup>53</sup> Ethical Investment Association (Submission 59).

<sup>54</sup> Corporate Law & Accountability Research Group (Submission 21).

This submission also argued for two further *mandatory* aspects to deal specifically with employee interests and four further *mandatory* duties to deal specifically with the interests of the broader community in achieving ecologically sustainable development and protection of the natural environment.

Another respondent<sup>55</sup> proposed that directors, in making decisions, be obliged to consider a defined list of social and environmental factors and to document in the board minutes that consideration has been given to these matters.

### *Oppose*

The pattern in submissions that were consistent with the business approach was to oppose any legal change to oblige directors to take into account the interests of specific classes of stakeholders, extending beyond shareholders, or the broader community, in corporate decision-making.

Many of the concerns with an obligatory provision of this nature were summed up in one submission.<sup>56</sup>

An amendment to the Corporations Act which requires directors to have regard to the interests of stakeholder groups would be likely to:

- *reduce flexibility*. By naming some stakeholders for special attention, questions are raised about the extent to which other interests must or may be taken into account.
- *potentially increase the range of persons who can sue directors*. While it is likely that many of such cases would not be successful, the very fact that the law says an interest must be taken into account is likely to increase ‘opportunistic’ litigation. This usually has a chilling effect on directors’ willingness to take business risks (the original purpose for allowing limited liability companies) and may ultimately reduce the availability of insurance because insurers will bear the greater legal costs of more litigation, even if the litigation is ultimately not successful.

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<sup>55</sup> A Papamatheos (Submission 31).

<sup>56</sup> Law Council of Australia (Submission 60).

- *reduce accountability.* This may seem counter-intuitive in light of the previous dot point, however, the current law provides a clear focus for directors' accountability. By broadening the interests which directors must take into account, it is likely also to provide a broader range of excuse for underperformance and give no guidance as to the circumstances in which one interest may or should weigh more heavily than another. ASIC, in its submission to the Parliamentary Joint Committee on Corporations and Financial Services, noted that broadening the scope of the interests that directors must take into account (or, pursuant to a "permission" provision, may take into account) may reduce effective enforcement.
- *it is likely to increase 'red tape'.* This is because directors will, in recording any decisions, seek to demonstrate that they have taken into account each interest which they are specifically required to take into account. This is likely to impose costs without countervailing benefit.
- *be of uncertain scope.* It is unclear whether a mandatory provision would apply only to listed companies or to all companies. There is no clear case why the mandatory provision should apply only to listed companies, given that there are very substantial unlisted companies and other forms of business organisation. It is equally unclear why the mandatory provision should not apply to individuals or other forms of business organisation if it did apply with justification to small companies.
- *have a disincentive effect.* It is possible that a mandatory provision would operate as a disincentive to companies incorporating in Australia. That would simply remove out of the reach of the Australian corporate regulator a range of companies doing business in Australia. That seems to be counter to good policy.

## 1.5.8 UK Companies Act approach

### *Terms of the Act*

Section 172 of UK *Companies Act 2006* is 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.

(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.

### *Support*

There was some support for the 'enlightened shareholder value' approach found in Section 172 of the UK Act. For instance:

In general, executives with responsibility for driving CSR initiatives and approaches do not feel that directors' duties, either under common law or under the Corporations Act, present a barrier to advancing a 'CSR agenda' within their companies ... however] ... Traditional views of shareholder value and corporate 'best interests' are woefully inadequate in the present time. They meet neither society's best interests, nor the long-term best interests of shareholders. Whilst broader interpretations of these concepts may not be directly prevented by existing legislation on directors' duties, it is important to point out that neither does the status quo encourage such broader considerations. Futureye

therefore submits that changes to the Corporations Act to elaborate on the considerations that should be made by directors with regard to stakeholder interests, long-term value, and intangible assets like corporate reputation, seem warranted. ... In Futureye's submission to the Joint Parliamentary Committee Enquiry, we have pointed out what we view as a need to further focus company directors and management on the creation of long-term value, and on the creation of long-term alignments between shareholder and stakeholder interests. It is becoming increasingly clear that in the long-run, ability to meet increasing community expectations of corporate social and environmental performance is the fundamental factor determining a company's licence to operate, in establishing reputation and brand equity, in determining its ability to attract and retain talented staff, and in shaping the regulatory environment in which corporations operate. An elaborated shareholder value approach to directors' duties could have a major impact in focusing directors on these issues. The power of such an approach lies in requiring directors to consider the long-term impact of their decisions, and the strategic risks and opportunities that are presented by social and environmental impacts and changing community expectations. ... Futureye thus generally supports the [UK *Companies Act 2006* s 172] as an appropriate precedent for change. It represents a well-considered attempt to establish an elaborated shareholder value approach. ... The provisions of the [UK *Companies Act*] as a precedent for change might be further strengthened by an additional requirement on directors to ensure regular consultation with local communities in relation to all activities that have a significant impact on the natural environment.<sup>57</sup>

Another respondent<sup>58</sup> commented that, while the current law does not specifically prevent companies from taking into account the interests of stakeholders, there exists considerable room for legislative improvement to ensure that companies do take non-shareholders' interests into account. That respondent supported the approach in the UK Act, with the following additional requirements:

This breadth and lack of specificity [particularly in (d) of the UK Act: 'the impact of the company's operations on the community and the environment'] is of some concern, given the wide variety of types of corporations. A method to address this may be to require each company to prepare a list

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<sup>57</sup> Futureye (Submission 19).

<sup>58</sup> NSW Young Lawyers (Submission 44).

of stakeholders it reasonably considers may be adversely affected by its activities, and submit this list to ASIC for authorisation. If a company fails to prepare a list or ASIC considers the list unreasonable, ASIC may mandate which stakeholders the company should consider, by considering the information listed in the corporation's annual report or calling for further reports from the directors, or from stakeholders. Alternatively, the list could be audited by professional auditors rather than by ASIC.

The list should be reviewed annually, and should be published in the company's annual report and/or on its website. Once the list is determined, the company must consider the listed stakeholders as part of its commercial decisions, taking a long-term view of the best interests of the company and ensuring (as per the Robert Hinkley suggestion [namely, a "Code for Corporate Citizenship"]) that the activities of the company are not at the expense of those stakeholders.

The argument that decisions would be impossible as stakeholder interests would conflict may be addressed by suggesting some appropriate considerations, such as:

- which stakeholders are most likely to be affected;
- the extent of the likely damage to the interests of those stakeholders; and
- whether compensatory or "off-set" mechanisms can be put in place to counteract the damage to certain stakeholders.

Another submission supported an additional statutory duty on directors to consider non-shareholder interests, based on the UK model.<sup>59</sup>

Another proposal was for a replaceable rule, loosely based on the wording of the UK Companies Act, and designed to protect directors who choose to give priority to longer-term over shorter-term considerations in their corporate decision-making (see further *Proposals* in Section 1.5.10, below).<sup>60</sup>

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<sup>59</sup> Public Interest Law Clearing House (Submission 22).

<sup>60</sup> A Lumsden and S Fridman, 'Corporate Social Responsibility: the case for a self regulatory model' *Company and Securities Law Journal* (forthcoming).

## Oppose

There was also opposition to introducing the equivalent of the UK Act provision into Australian law. For instance:

ASIC thinks that an amendment based on [s 172 of the UK *Companies Act 2006*] may, in fact, create uncertainty. Clause 156 lists a number of matters that directors ‘must (so far as reasonably practicable) have regard to’. Such a list may create uncertainty because directors will, for example, be unsure about:

- the relative weight of matters on the list and, in particular, whether all matters on the list should be given equal weight; and
- whether they can have regard to matters not on the list and whether matters not on the list should be given the same importance as those on the list.

As stated in ASIC’s submission to the Parliamentary Joint Committee Inquiry, this sort of uncertainty is of particular concern to ASIC because it is difficult to enforce uncertain legislative provisions.

In general, ASIC considers that the range of matters that may have to be considered by directors are potentially so varied that it would be better to retain the flexibility of the current common law, rather than to force directors to have regard to a list of matters that may be inappropriate for the circumstances of their particular corporation.<sup>61</sup>

### 1.5.9 Ethical judgment rule

One respondent<sup>62</sup> proposed the concept of an ‘ethical judgment rule’, designed to give directors some protection from liability in the event that their ethical decision caused a detrimental impact on the financial interests of the company as a whole:

we would recommend an amendment to the Corporations Act, similar to the provisions relating to the ‘business judgement rule’, allowing company directors to make decisions based on *bona fide* ethical considerations (including but not limited to the interests of stakeholders other than shareholders)—and protecting them from liability

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<sup>61</sup> ASIC (Submission 55).

<sup>62</sup> St James Ethics Centre (Submission 33).

for doing so when a reasonable person would judge those considerations to be well founded. This protection should be afforded in all cases—including when the decision may have some detrimental effect on the financial interests of the company as a whole, its shareholders or some group of them. As such, directors relying on the ‘ethical judgement rule’ as a defence, would be required to produce documents demonstrating the quality of the reasoning employed in reaching their decision. Courts would only be entitled to review the substance of any decision if the quality of the decision-making process was first found to be inadequate.

The submission did not discuss how the proposed rule would interrelate with the current business judgment defence in s 180(2) of the Corporations Act, and how to avoid the proposed rule being used by directors as a shield for poor business judgments.

### 1.5.10 Responding to short-termism

#### *The perceived problem*

A theme in some of the submissions was an assertion that too many companies make decisions based on short-termism and thereby neglect or subordinate the long-term environmental and other societal consequences of their operations.

For instance:

Corporations make decisions based on short-term pay-back periods and therefore neglect the long-term consequences of their organisations operations. Managers of corporations are rewarded and incentivised, not by how they minimise the impacts the corporation is having on negative externalities (environmental & social impacts) but rather the profit that can be generated in short time frames generally of 1, 2 and 3 year periods. Corporations and the personnel that run them are constantly encouraged to develop strategies that generate satisfactory profits over relatively short time horizons.<sup>63</sup>

There remains a focus on short-term indicators, eg, share price, at the expense of the long-term sustainability of the company. In sections of Australian corporate culture this tends to hinder the ability of some corporate

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<sup>63</sup> T Heesh (Submission 27).

decision-makers to recognise long-term costs and externalities.<sup>64</sup>

Likewise, it was argued that market analysts, who play a prominent role in influencing market prices, have very short time horizons and have little or no real interest in the kinds of longer-term societal factors that are at the core of corporate social responsibility notions.<sup>65</sup>

### *Proposals*

There were contrasting approaches to this short/long-term issue.

One approach was to place greater obligations on directors to take long-term matters into account. The other approach was to give greater protection to directors who choose long-term over short-term considerations in corporate decision-making.

### *Additional requirement for the business judgment defence*

One respondent<sup>66</sup> argued for a revision to the business judgment rule in s 180(2) to oblige directors and officers to take longer-term considerations into account before they can rely on the business judgment defence:

However, one of the challenges and responsibilities for directors is to balance the different timeframes that different stakeholders may be operating under and the tangibility of any outcome of a decision. For example, a short-term decision to return capital to current shareholders of a company may result in poorer services to customers, ultimately leading to under-investment and poorer longer-term returns for shareholders. Alternatively directors may choose to invest in the business to improve services at the expense of returning capital to shareholders by building a long-term customer base and company profitability. In other company circumstances and after considering both and long-term issues, the directors' decision to return capital to current shareholders may be totally appropriate action ...

Given the disparate views on the role of stakeholder issues and timeframes under which directors should be operating, it is not surprising that Director's may feel uncertain about

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<sup>64</sup> RepuTex (Submission 47). Ernst & Young (Submission 29) also raised the question of balancing short-term and long-term considerations.

<sup>65</sup> Australian Conservation Foundation (Submission 34).

<sup>66</sup> AMP Capital Investors (Submission 58).

their duties. Faced with this uncertainty, it is also not surprising that some Directors may take a risk averse or a narrow legal interpretation of their duties, to the detriment of shareholders and stakeholders.

Therefore, it appears that it is appropriate to clarify the duties of directors. Clarification can be achieved through the following, or similar, revision:

*s 180(2)(d) rationally believe that the judgement is in the best long-term interest of the corporation, taking into consideration the interest of legitimate stakeholders and the environment.*

This respondent also proposed a further additional prerequisite before directors and officers could rely on the business judgment defence (see Section 1.5.11, below).

#### *Replaceable rule*

Another proposal<sup>67</sup> was for a replaceable rule (based loosely on the language of s 172 of the UK *Companies Act 2006*) designed to protect directors and officers if they prefer long-term over short-term considerations in determining what is in the best interests of the corporation. According to the authors, the replaceable rule would not be geared at driving behavioural change amongst directors and other corporate officers, but rather at facilitating conduct in which many of them are already engaged:

Directors and officers [managers] can and should consider the long and short term interests of the corporation without undue fear that they might be unduly increasing their liability by doing so ... managers may put a corporation's survival at risk if they solely pursue profits and fail to take into account the wider impact of their decisions ... there is some advantage in providing a moderate level of protection for those [managers] who want to take the long view, managers who divert for some time from the pure 'wealth maximisation norm'.

The authors considered that the balance between short-term and long-term considerations should be a matter for the corporate constitution:

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<sup>67</sup> A Lumsden and S Fridman, 'Corporate Social Responsibility: the case for a self regulatory model' *Company and Securities Law Journal* (forthcoming).

If corporations have come to acquire social responsibilities that go beyond shareholder wealth maximisation, those responsibilities need to be explicitly accepted by both shareholders and management through the contract that binds them to each other, the constitution.

The replaceable rule:

would thus form part of the contract between the members and the corporation as well as between the officers and the corporation. Any further consideration of such a provision, including modification or possible rejection, would be the exclusive province of members. It would also not be open to regulators, stakeholders or anyone else who was not a member or officer to enforce against managers.

The directors could rely on that rule if they:

had taken a decision favouring the long term sustainability of the corporation which resulted in financial detriment to the current shareholders.

### **1.5.11 Licence to operate approach**

Various submissions sought to support their position, either for or against any legislative change, by arguing that their approach is consistent with the role of the corporate form, sometimes described in terms of a social ‘licence to operate’.

#### *Need for legislative change*

An argument put forward in some submissions was that the corporate form, with limited liability, is a creation of society, a privilege not an inherent right, and that the possession of social decision-making power by companies is legitimate only if limited liability is in the public interest, measured by reference to various environmental and social principles or goals. Business only has a ‘licence to operate’ if it takes responsibility for its social and environmental consequences.

Within that context, one respondent<sup>68</sup> argued for a revision to the business judgment rule in s 180(2) to require directors and officers

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<sup>68</sup> AMP Capital Investors (Submission 58).

to consider ‘legitimate stakeholder expectations’ as an additional requirement for making proper business judgments:

“Limited liability” came about from a weighing up of the cost and benefits to broader society of allowing the owners of companies the financial benefit of minimising the downside risks of entrepreneurial endeavours. It was, and still is, a privilege granted to companies by society, through company law for which companies, shareholders and society also benefits. Implicit in being granted the privilege is the responsibility to ensure that the company meets the minimum expectations of acceptable corporate behaviour and provides a benefit to society, which requires having regard to, and understanding of the impact of its operations on legitimate stakeholders.

However, the Corporations Law appears not to encourage a company to meet its social contract. This becomes particularly important at times when the company’s interest, especially in the short term, may be in conflict with the community’s expectation of appropriate corporate behaviour.

Therefore, through having regard for legitimate stakeholders, companies can both meet their implied responsibility as part of limited liability and being a legitimate player in civil society and minimise the risk of burdensome legal requirements. Considering the interests of many of a company’s key stakeholders is also required as part of good business practice. Consequently, an appropriate requirement for directors can be achieved with the following revision:

*s 180(2)(e) have considered community, and legitimate stakeholder expectations, on appropriate corporate behaviour.*

### ***No need for legislative change***

A contrary theme in various submissions was that the concept of limited liability that underpins the corporate form, while certainly a franchise granted by society, is nevertheless fundamental to the growth and success of companies and their continuing economic and social contributions. Many successful enterprises could not be established, or continue to operate successfully, and provide goods and services to meet consumer demands without equity contributors, protected by limited liability, and debt funding. Either form of capital, and thus the operation of the market economy, may be

jeopardised to the extent that the focus of directors is distracted, or forced to move away, from the primary role of companies in satisfying consumer demands and thereby generating corporate profits.

### **1.5.12 Statutory elaboration of corporate decision-making framework**

One respondent<sup>69</sup> proposed legislative guidance in the form of a framework identifying the range of factors that directors and others should be entitled to take into account in corporate decision-making, such as:

- (1) the immediate, near-term, and long-term consequences of corporate decisions and activities;
- (2) the sustainability of the company and its ongoing success;
- (3) the need for a fair and proper return to shareholders for their investment in the company;
- (4) the need for due consideration and treatment of all interests in the corporate constituency (however defined), according to their relationship to the company's success (including the need for members to be treated 'fairly', according to their particular rights of membership);
- (5) the establishment and nourishing of essential business, credit, and employment relationships, including appropriate investment in employee education and training;
- (6) the need to comply with corporate regulatory requirements as a necessary but not sufficient condition for achieving corporate success, and the interdependence between interests within the corporate constituency in meeting both of these conditions for corporate success;
- (7) the need for stakeholder-sensitive elements that are relevant to a company's success to be embedded within the company's ordinary decision-making and other frameworks, processes, and procedures

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<sup>69</sup> B Horrigan (Submission 12).

- for—amongst other things—risk management, operational reviews, strategy, and reporting;
- (8) the importance of a company’s reputation for certain values (eg product and service quality, business ethics, customer satisfaction, fair pricing, and other CSR-related values) to its competitiveness and success;
  - (9) the desirability of minimizing or eliminating avoidable adverse effects of the company’s activities and decisions upon local communities, the environment, and society generally; and
  - (10) the appropriateness of particular kinds of corporate contributions to society’s governance and prosperity, including contributions of socio-economic, environmental, and ‘free enterprise’ benefit.

According to that respondent:

A legislative entitlement for directors to consider shareholder and stakeholder interests within a broad framework of decision-making considerations will clarify and enhance existing law.

### 1.5.13 Employee representation on the board

One respondent<sup>70</sup> proposed employee representation on the board of directors, following the German precedent:

It is submitted that having employee representation on the board is a realistic recognition of the employees’ interest in the continued success and viability of the large modern corporation. At present times, when most large corporations have employee share plans, which are also recognition of an employees’ interest in the corporation, is it not time to more formally recognise the employees’ interest in the corporation?

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<sup>70</sup> T Ponnambalam (Submission 13).

### 1.5.14 Mandatory stakeholder advisory boards

One respondent<sup>71</sup> proposed that:

non trivial corporations be required to adopt constitutions that allow stakeholders to form advisory councils that represent the various constituencies of the corporation to inform the directors on business operations and any other matters of concern such as social and environmental issues.

Also:

A legal requirement for non-trivial corporations to facilitate a process for constituents of a company to form advisory boards would provide a basis for reducing the scope of information that the law requires directors to report as the onus could be transferred to various councils or boards. It is the Stakeholder Councils, not the directors that should be required to present in corporate annual reports of non-trivial corporations the social and environmental impact of the business.

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<sup>71</sup> S Turnbull (Submission 2).

## 2 Corporate disclosure

*This chapter summarises the range of views in submissions on the adequacy of the current requirements concerning environmental and social reporting by corporations and outlines a range of proposals by various respondents to amend those requirements.*

*An abbreviated version of this summary is found in Section 4.9 of the Advisory Committee report **The social responsibility of corporations** (December 2006).*

### 2.1 Terms of reference

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?

### 2.2 Environmental and social reporting in Australia

It appears that social and environmental reporting in Australia is not as widespread as in other jurisdictions. For instance, one respondent<sup>72</sup> pointed out that:

- less than a quarter of ASX 100 companies produce a social or environmental report<sup>73</sup>
- only 31 of the ASX top 500 issue such a report<sup>74</sup>

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<sup>72</sup> Australian Centre for Corporate Social Responsibility (Submission 37).

<sup>73</sup> KPMG International Survey of Corporate Responsibility Reporting 2005 (Amsterdam: KPMG Global Sustainability Services) at 55.

<sup>74</sup> G Frost, S Jones, J Loftus & S Van der Laan, 'A Survey of Sustainability Reporting Practices of Australian Reporting Entities' (2005) 15 *Australian Accounting Review* 89.

- by comparison, over half the world's top 250 companies issue a social or environmental report.<sup>75</sup>

### 2.3 Overview of submissions

Almost all respondents agreed that environmental and social reporting is desirable, as financial reporting provides only a partial view of a company's operations. ASIC (Submission 55) considered that an additional reporting requirement would be a better regulatory tool than amending directors' duties, as it would give stakeholders the information that they need to make decisions about a company's behaviour that reflect their own interests and opinions.

Some submissions considered that additional reporting should be mandatory,<sup>76</sup> while others considered that any additional reporting should be voluntary only, assisted by guidelines<sup>77</sup> (though some of these considered that even voluntary reporting can be 'self serving propaganda'<sup>78</sup>).

The key factors identified by submissions as relevant to determining the best framework for additional reporting were:

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<sup>75</sup> KPMG International Survey of Corporate Responsibility Reporting 2005 (Amsterdam: KPMG Global Sustainability Services).

<sup>76</sup> Environment Institute of Australia and New Zealand (Submission 15), Corporate Law and Accountability Research Group (Submission 21), Public Interest Law Clearing House, Vic (Submission 22), M Nehme (Submission 25), T Heesh (Submission 27), Australian Conservation Foundation (Submission 34), J Raar (Submission 35), Australian Centre for Corporate Social Responsibility (Submission 37), NSW Young Lawyers (Submission 44), RepuTex (Submission 47), AMP Capital Investors (Submission 58), Ethical Investment Association (Submission 59).

<sup>77</sup> T Bostock (Submission 1), Group of 100 (Submission 4), Business Roundtable on Sustainable Development (Submission 5), Chartered Secretaries Australia (Submission 26), Ernst & Young (Submission 29), Credit Union Industry Association (Submission 32), Hermes Pension Management Ltd, UK (Submission 38), ANZ (Submission 40), QBE Insurance Group (Submission 42), AICD (Submission 43), National Australia Bank (Submission 45), Coles Myer (Submission 46), WA Chamber of Commerce and Industry (Submission 48), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>78</sup> T Bostock (Submission 1), T Wilson (Submission 8).

- *comparability*: this criterion was cited by those who supported mandatory reporting<sup>79</sup> and those who supported additional voluntary frameworks.<sup>80</sup> One submission<sup>81</sup> pointed out that studies of disclosures made by a number of publicly listed companies show that disclosures range significantly in content and quality
- *cost*: some submissions said that mandatory reporting would reduce costs, for instance, by standardising reporting requirements,<sup>82</sup> or that the benefits of mandatory reporting would outweigh the costs,<sup>83</sup> while other submissions said that additional mandatory reporting would be too costly<sup>84</sup>
- *flexibility*: this factor was cited by submissions favouring voluntary reporting only,<sup>85</sup> though submissions that favoured additional mandatory reporting denied that legislative requirements would necessarily remove flexibility, given that they could allow for differences between different industries<sup>86</sup>
- *innovation*: some submissions said that mandating additional environmental and social reporting would stifle innovation.<sup>87</sup> Other submissions<sup>88</sup> disagreed with that contention. Some considered that further mandatory reporting need not stifle

<sup>79</sup> Public Interest Law Clearing House, Vic (Submission 22), M Nehme (Submission 25), Chartered Secretaries Australia (Submission 26), Australian Conservation Foundation (Submission 34), J Raar (Submission 35), NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>80</sup> B Horrigan (Submission 12), Chartered Secretaries Australia (Submission 26), Ernst & Young (Submission 29), Credit Union Industry Association (Submission 32), St James Ethics Centre (Submission 33), Hermes Pension Management Ltd, UK (Submission 38), Lend Lease (Submission 39), AICD (Submission 43).

<sup>81</sup> NSW Young Lawyers (Submission 44).

<sup>82</sup> NSW Young Lawyers (Submission 44).

<sup>83</sup> NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>84</sup> T Bostock (Submission 1), Credit Union Industry Association (Submission 32), ABA (Submission 49), H Bosch (Submission 51).

<sup>85</sup> Hermes Pension Management Ltd, UK (Submission 38), AICD (Submission 43), National Australia Bank (Submission 45), Coles Myer (Submission 46), ABA (Submission 49), H Bosch (Submission 51), Business Council of Australia (Submission 57).

<sup>86</sup> Public Interest Law Clearing House, Vic (Submission 22), Australian Centre for Corporate Social Responsibility (Submission 37).

<sup>87</sup> Credit Union Industry Association (Submission 32), AICD (Submission 43) (indirectly: 'Companies should be able to distinguish themselves in this area'), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>88</sup> Australian Conservation Foundation (Submission 34), Australian Centre for Corporate Social Responsibility (Submission 37), RepuTex (Submission 47).

innovation if companies have latitude in their selection of indicators and style of reporting.<sup>89</sup> Another submission suggested mandatory reporting may even create incentives for firms to outperform their competitors by developing innovative reporting methods<sup>90</sup>

- *market advantage*: some submissions that favoured additional mandatory reporting considered that it would benefit responsible companies by improving their reputation in the relevant markets or by assisting them to obtain positive risk assessments from analysts and thereby to attract investment capital,<sup>91</sup> while another submission considered that allowing each company to decide whether to engage in additional reporting would give those who do so an advantage over their competitors<sup>92</sup>
- *improving corporate behaviour*: some submissions said that mandatory disclosure improves corporate behaviour,<sup>93</sup> while others considered that it promotes a culture of compliance and a ‘tick the box’ mentality.<sup>94</sup>

ASIC (Submission 55), which would support the government if it decided to introduce mandatory reporting, cited the comparability, cost and flexibility criteria.

## 2.4 Submissions supporting additional mandatory environmental and social reporting

Sections 4.5 and 4.6 in Chapter 4 of the Advisory Committee report set out the current reporting requirements under the Corporations Act and the ASX requirements.

<sup>89</sup> Australian Centre for Corporate Social Responsibility (Submission 37), RepuTex (Submission 47).

<sup>90</sup> Australian Conservation Foundation (Submission 34).

<sup>91</sup> Australian Centre for Corporate Social Responsibility (Submission 37), NSW Young Lawyers (Submission 44).

<sup>92</sup> AICD (Submission 43).

<sup>93</sup> Environment Institute of Australia and New Zealand (Submission 15), Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>94</sup> Chartered Secretaries Australia (Submission 26), Ernst & Young (Submission 29), Hermes Pension Management Ltd, UK (Submission 38), AICD (Submission 43), WA Chamber of Commerce and Industry (Submission 48), H Bosch (Submission 51), Business Council of Australia (Submission 57).

Various respondents supported additional mandatory environmental and social reporting requirements. Reasons given were:

### *Current disclosures insufficient*

- voluntary reporting has resulted in sporadic, inconsistent, incomplete and biased information and does not adequately achieve meaningful and consistent reporting information for a broader range of stakeholders.<sup>95</sup>
- very few companies have been reporting on environmental matters<sup>96</sup>
- there is little or no requirement for entities to report information pertaining to social performance<sup>97</sup> and few companies have adopted uniform standards by which social performance can be reported<sup>98</sup>
- the current Corporations Act and voluntary disclosure do not enable a full evaluation of the effect of a company's activities or a comparison between companies.<sup>99</sup> In particular:

#### *s 299(1)(f)*

- under this provision, stakeholders cannot always accurately compare the performance of two similar companies due to different approaches taken to the reporting of non-financial information and different understandings of what constitutes a 'particular and significant environmental regulation'.<sup>100</sup> That phrase could mean an environmental regulation that has particular application only to the reporting entity or it could involve the reporting entity being subject to an environmental regulation that has general application within the jurisdiction, but has 'particular' significance to the reporting entity by reason of the nature or extent of its operations

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<sup>95</sup> Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44).

<sup>96</sup> NSW Young Lawyers (Submission 44).

<sup>97</sup> NSW Young Lawyers (Submission 44).

<sup>98</sup> RepuTex (Submission 47).

<sup>99</sup> Corporate Law and Accountability Research Group (Submission 21), Australian Centre for Corporate Social Responsibility (Submission 37), NSW Young Lawyers (Submission 44), AMP Capital Investors (Submission 58).

<sup>100</sup> NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

*s 299A*

- this provision has limited application, namely to listed public companies<sup>101</sup>
- this provision allows the omission of unfavourable economic, environmental and social information if that information is likely to result in unreasonable prejudice to the company (unless disclosure of the information is required by s 299(1)(f))<sup>102</sup>

*Encourage higher standard of reporting*

- mandatory reporting would heighten transparency of extra-financial and material risks<sup>103</sup>
- it would provide more balanced reporting, with companies required to report information that is unfavourable, as well as information that is favourable, to their image<sup>104</sup>
- jurisdictions that have mandatory reporting have a better standard of environmental and social reporting than Australia<sup>105</sup>

*Adequate information for investors and analysts*

- individuals and institutions should be able to make investment decisions fully informed of the environmental, social, and governance activities of the companies in which they invest, which presupposes a certain level of disclosure about these matters<sup>106</sup>
- the disclosure of information relating to long-term value complements the long-term investment time horizon of superannuation investors<sup>107</sup>

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<sup>101</sup> NSW Young Lawyers (Submission 44).

<sup>102</sup> NSW Young Lawyers (Submission 44).

<sup>103</sup> RepuTex (Submission 47).

<sup>104</sup> NSW Young Lawyers (Submission 44).

<sup>105</sup> RepuTex (Submission 47).

<sup>106</sup> Australian Conservation Foundation (Submission 34), Australian Centre for Corporate Social Responsibility (Submission 37), Ethical Investment Association (Submission 59).

<sup>107</sup> Ethical Investment Association (Submission 59).

- environmental issues are integral to the existence, operation and profitability of all corporations, in every industry throughout the world, as they use natural resources as productive inputs, consume energy generated from natural resources, produce physical products and packaging that inhabit the environment and emit waste substances into the environment<sup>108</sup>
- investors should have adequate information to monitor the activities of corporate boards<sup>109</sup>

### *Comparability between companies*

- current disclosure practices range in format, quality and scope, with some companies providing very little information due to ambiguity about the extent of environmental reporting required<sup>110</sup>
- mandatory reporting would improve comparability of reported information between different companies<sup>111</sup>
- if reporting is not mandatory, the benefits for companies that prepare environmental and social reports are reduced because those companies expose themselves to public scrutiny and criticism from which their less responsible peers are shielded<sup>112</sup>
- the credibility of all reports is reduced by the lack of any baseline of required disclosures<sup>113</sup>

### *Improve corporate practices*

- it would entrench transparency and sustainability as core business principles<sup>114</sup>
- it would assist companies in providing for sustainability and long-term economic survival<sup>115</sup>

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<sup>108</sup> Ethical Investment Association (Submission 59).

<sup>109</sup> Australian Conservation Foundation (Submission 34).

<sup>110</sup> NSW Young Lawyers (Submission 44).

<sup>111</sup> Public Interest Law Clearing House, Vic (Submission 22), M Nehme (Submission 25), J Raar (Submission 35), NSW Young Lawyers (Submission 44).

<sup>112</sup> Australian Conservation Foundation (Submission 34).

<sup>113</sup> Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44).

<sup>114</sup> Australian Conservation Foundation (Submission 34), RepuTex (Submission 47).

- increased transparency could reduce the likelihood of corporate behaviour that has an adverse effect on the community<sup>116</sup>
- it would improve corporate reputation<sup>117</sup>
- companies whose corporate reporting demonstrates that they are focused on long-term existence may find it easier to attract and retain high quality employees<sup>118</sup>

### *Saving in some costs*

- mandatory reporting would establish a definable standard for business and minimise transaction costs in responding to various queries relating to social and environmental performance<sup>119</sup>
- the costs of producing expensive public relations reports would be reduced by focusing business on the management issues at hand and including this information in the annual report to shareholders<sup>120</sup>

### *Benefits outweigh the costs*

- the costs of increased reporting would be negated by risk reduction, increased stakeholder confidence in the reporting entity and savings arising from understanding what does and does not need to be reported, as well as by non-economic factors such as employee satisfaction and corporate reputation<sup>121</sup>
- while there may be a risk of liability in relation to the reliability of the content of environmental and social reports, litigation costs are unlikely to be significant and the risk could be overcome by mandatory auditing of those reports<sup>122</sup>

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<sup>115</sup> NSW Young Lawyers (Submission 44).

<sup>116</sup> Environment Institute of Australia and New Zealand (Submission 15), RepuTex (Submission 47).

<sup>117</sup> NSW Young Lawyers (Submission 44).

<sup>118</sup> NSW Young Lawyers (Submission 44).

<sup>119</sup> NSW Young Lawyers (Submission 44).

<sup>120</sup> NSW Young Lawyers (Submission 44).

<sup>121</sup> NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>122</sup> NSW Young Lawyers (Submission 44).

### *Improved communication*

- mandatory reporting could improve dialogue with relevant stakeholders<sup>123</sup>

### *Consistency with international practice*

- it would not disadvantage Australian companies, as many countries have already adopted mandatory corporate responsibility reporting<sup>124</sup>

### *Better access to capital*

- improved reporting on environmental and social issues may assist in attracting capital from investors and ethical funds<sup>125</sup>

### *Enforceability*

- it would make corporate social responsibility standards enforceable<sup>126</sup>

### *Regulatory neutrality*

- listed companies should be subject to the same disclosure requirements concerning labour standards and environmental, social or ethical considerations as product issuers (s 1013D)<sup>127</sup>

### *Assist in identifying regulatory gaps*

- it would provide a basis for regulators to identify areas where further regulation may be necessary.<sup>128</sup>

One of the submissions supporting mandatory reporting questioned the motives of many of those who oppose it.<sup>129</sup> On the one hand, leading social reporters may lose the reputational benefit of reporting if it were made mandatory. On the other hand, non-reporters would be reluctant to incur the additional costs that reporting would require.

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<sup>123</sup> NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>124</sup> NSW Young Lawyers (Submission 44).

<sup>125</sup> NSW Young Lawyers (Submission 44).

<sup>126</sup> NSW Young Lawyers (Submission 44).

<sup>127</sup> Ethical Investment Association (Submission 59).

<sup>128</sup> T Heesh (Submission 27).

<sup>129</sup> Australian Centre for Corporate Social Responsibility (Submission 37).

## 2.5 Submissions opposing additional mandatory social and environmental reporting

The reasons given by these submissions included:

### *Lack of flexibility*

- it would limit a company's ability to determine what best suits its reporting needs and the needs and expectations of its stakeholders and the wider community<sup>130</sup>
- it is difficult to mandate meaningful and consistent reporting, given that companies are diverse in their maturity, operations and scope and differ in relation to the dynamics of the relevant industry, market sector and operating environment<sup>131</sup>
- even the GRI would not be suitable as a mandatory reporting framework, as not all its criteria or indicators will be relevant to all businesses<sup>132</sup>
- the real and comparative influence of, and priority assigned to, varying stakeholder interests will be different for different companies<sup>133</sup>
- regulation is slow to change and may create a barrier to the ability of corporations to respond to and report on their operations in the context of changing societal expectations and needs<sup>134</sup>
- mandatory reporting may not take account of divergent geographic and industry sector characteristics<sup>135</sup>
- market-driven disclosure is more easily tailored to the individual profile of companies and the emerging expectations of investors and other users of reports<sup>136</sup>

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<sup>130</sup> AICD (Submission 43), ABA (Submission 49).

<sup>131</sup> National Australia Bank (Submission 45), Coles Myer (Submission 46), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>132</sup> ABA (Submission 49).

<sup>133</sup> ABA (Submission 49).

<sup>134</sup> National Australia Bank (Submission 45), H Bosch (Submission 51).

<sup>135</sup> Hermes Pension Management Ltd, UK (Submission 38).

*Too costly*

- it would involve too much expense and divert corporate resources from more productive corporate activities<sup>137</sup>

*Stifling innovation*

- it runs the risk of stifling innovation and competition between companies and the application of best practice<sup>138</sup>

*Impossible to devise appropriate guidelines*

- it is not possible to devise universally applicable ('one size fits all') guidelines for environmental and social reporting,<sup>139</sup> as, for instance:
  - not all companies will have governance practices to report against all possible criteria, or responsibilities to all possible stakeholders<sup>140</sup>
  - it would be impractical to attempt to capture certain performance criteria or reporting indicators in either the law or listing rules<sup>141</sup>
  - no single model would suit all types and sizes of companies. For instance, the issues facing a multinational mining company dealing with a range of local communities, a telecommunications company with significant operations in rural and regional Australia and a small listed information technology company are very different<sup>142</sup>

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<sup>136</sup> ANZ (Submission 40), AICD (Submission 43).

<sup>137</sup> Credit Union Industry Association (Submission 32), H Bosch (Submission 51).

<sup>138</sup> Credit Union Industry Association (Submission 32), AICD (Submission 43) (indirectly: 'Companies should be able to distinguish themselves in this area'), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>139</sup> Group of 100 (Submission 4), Credit Union Industry Association (Submission 32), AICD (Submission 43), National Australia Bank (Submission 45), ABA (Submission 49).

<sup>140</sup> ABA (Submission 49).

<sup>141</sup> ABA (Submission 49).

<sup>142</sup> AICD (Submission 43).

- companies deal with environmental and social issues differently at different stages in their development<sup>143</sup>
- legislative environmental and social reporting standards would be either too complex and prescriptive or too high level to provide practical guidance across the various industry sectors and companies, and therefore unenforceable<sup>144</sup>

### *Formal rather than substantive response*

- mandatory reporting may foster minimum compliance and a ‘tick the box’ approach<sup>145</sup>

### *Unnecessary*

- responsible businesses already voluntarily report their performances and subject themselves to independent auditing and rating<sup>146</sup>
- companies in the insurance, mining and banking sectors see good reporting as part of good business practices and as giving them an advantage over their competitors<sup>147</sup>
- investors increasingly require companies to make environmental and social disclosures<sup>148</sup>
- the current situation is highly self-regulatory, with the market (for the company’s goods and services, as well as for labour and capital) being a powerful force for superior performance<sup>149</sup>
- for listed companies, this area is already covered by ASX Principles 3, 7 and 10, under which companies report on their promotion of ethical and responsible decision-making, their recognition and management of risk (both financial and non-financial risks) and their recognition of their legal and other

<sup>143</sup> AICD (Submission 43).

<sup>144</sup> AICD (Submission 43), Coles Myer (Submission 46), ABA (Submission 49).

<sup>145</sup> Chartered Secretaries Australia (Submission 26), Ernst & Young (Submission 29), Hermes Pension Management Ltd, UK (Submission 38), AICD (Submission 43), H Bosch (Submission 51), Business Council of Australia (Submission 57).

<sup>146</sup> AICD (Submission 43), National Australia Bank (Submission 45), WA Chamber of Commerce and Industry (Submission 48), ABA (Submission 49).

<sup>147</sup> AICD (Submission 43).

<sup>148</sup> AICD (Submission 43).

<sup>149</sup> ANZ (Submission 40), AICD (Submission 43).

obligations to their legitimate stakeholders. Standards Australia Corporate Governance Guidelines have also been widely adopted voluntarily by listed, unlisted, public and private sector bodies in Australia<sup>150</sup>

### *Generally agreed standards not yet settled*

- any attempt to mandate reporting would be premature and counterproductive, given:
  - rapidly emerging developments and changing and diverse needs of stakeholders and society in Australia and overseas<sup>151</sup>
  - the lack of any benefit in pre-empting the ongoing international debate in this area<sup>152</sup>
  - the lack of standardised or precise performance criteria or reporting indicators or guidance on reporting intangibles, with a consequent lack of comparability of company performance<sup>153</sup>
- the difficulty of wholesale adoption of overseas approaches in Australia before the position is settled internationally was illustrated by the recent Australian move to international accounting standards, some of which are proving to be unsuited to Australian conditions<sup>154</sup>

### *Undermine accountability*

- imposing vague and inconsistent social and environmental reporting obligations on corporations though legislation would undermine the accountability of corporate management to shareholders<sup>155</sup>

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<sup>150</sup> AICD (Submission 43).

<sup>151</sup> AICD (Submission 43), National Australia Bank (Submission 45), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>152</sup> AICD (Submission 43).

<sup>153</sup> Credit Union Industry Association (Submission 32), ABA (Submission 49).

<sup>154</sup> AICD (Submission 43).

<sup>155</sup> WA Chamber of Commerce and Industry (Submission 48).

### *Analogy with financial reporting invalid*

- reporting is often seen as a way for stakeholders to keep companies accountable for their social and environmental performance in the same way that financial reporting keeps boards of directors and chief executives accountable to owners. However, information about a company's social and environmental activities is not like financial information and comparing financial performance across firms is considerably easier than comparing social and environmental performance. Is one entity's involvement with indigenous communities better than donations made by another entity to a children's charity?<sup>156</sup>

## **2.6 Options for reporting**

This section summarises the views of submissions on the following reporting options:

- Option 1: voluntary reporting, whether strictly on its own (that is, repealing existing Corporations Act and ASX requirements) or as a supplement to current statutory and exchange-based reporting. This could be either:
  - Option 1A: purely voluntary reporting, or
  - Option 1B: voluntary reporting with government support
- Option 2: further guidance on how to comply with current reporting requirements
- Option 3: augmented ASX and other exchange requirements, for instance:
  - Option 3A: expand on the 'if not, why not' reporting guidelines in Principles 3, 7 and 10 of the Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* by incorporating environmental and social reporting guidelines, based, for instance, on the GRI or the UK OFR [under the November 2006 Corporate Governance Council draft

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<sup>156</sup> WA Chamber of Commerce and Industry (Submission 48).

amendments, the reporting aspects of Principle 10 have been moved under Principle 7]

- Option 3B: require all listed entities to report, based, for instance, on the GRI or the UK OFR
- Option 4: legislative reporting requirements
  - Option 4A: ‘if not, why not’ reporting
  - Option 4B: mandatory reporting.

These options are not necessarily mutually exclusive and some submissions supported a combination of options.<sup>157</sup>

### 2.6.1 Option 1: Voluntary reporting

#### *Option 1A: Purely voluntary reporting*

Many submissions favoured a voluntary disclosure approach.<sup>158</sup>

Some of those submissions favoured the GRI as voluntary reporting guidelines.<sup>159</sup>

One submission favoured a mixture of voluntary disclosure and mandatory disclosure, with the voluntary and mandatory elements being clearly distinguishable.<sup>160</sup> The mandatory element proposed by that respondent is discussed in *Human rights reporting* under Option 4B in Section 2.6.4, below. The respondent considered that voluntary public reporting on socially responsible business practices should be encouraged and should incorporate reference to established international human rights standards.

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<sup>157</sup> St James Ethics Centre (Submission 33), Amnesty International Australia (Submission 54).

<sup>158</sup> Group of 100 (Submission 4), Chartered Secretaries Australia (Submission 26), Ernst & Young (Submission 29), Credit Union Industry Association (Submission 32), Hermes Pension Management Ltd, UK (Submission 38), Lend Lease (Submission 39), National Australia Bank (Submission 45), CPA Australia (Submission 56), Business Council of Australia (Submission 57).

<sup>159</sup> Ernst & Young (Submission 29), Credit Union Industry Association (Submission 32), Lend Lease (Submission 39), National Australia Bank (Submission 45).

<sup>160</sup> Amnesty International Australia (Submission 54).

### *Option 1B: Voluntary with government support*

Two submissions advocated voluntary reporting with some form of government support.<sup>161</sup>

One of those submissions<sup>162</sup> suggested:

- a common voluntary reporting framework, with the corporate implementation costs to be subsidised initially by government (the submission supported the Corporate Responsibility Index (CRI) as the common reporting framework)
- a limited prescriptive regime for companies that opt not to adopt the voluntary system (see Option 4B in Section 2.6.4, below). The government could ask the ASX and ASIC to deliver minimum mandatory reporting standards, to ensure that all annual reports, without having to adopt a specific form, include a minimum level of basic information about corporate responsibility (if not at the level required by instruments such as the CRI).

This reporting system would combine the advantages of voluntary reporting with the protection of regulated minimum standards for those who do not take on the voluntary initiatives.

The support envisaged by the other submission<sup>163</sup> would take the form of:

- ensuring the credibility and rigour of published benchmarks and indices
- ensuring that any conflicts of interest of index operators are appropriately disclosed and managed.

### **2.6.2 Option 2: guidance**

One submission suggested enhancing s 299(1)(f) and the ASX guidelines (in particular, Principle 7 of the Principles of Corporate Governance and Best Practice Recommendations) by best practice guidance, which could be developed in co-operation between ASIC

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<sup>161</sup> St James Ethics Centre (Submission 33), ANZ (Submission 40).

<sup>162</sup> St James Ethics Centre (Submission 33).

<sup>163</sup> ANZ (Submission 40).

(based on its experience in developing its s 1013DA disclosure guidelines), the ASX Corporate Governance Council, the Department of the Environment and Heritage (based on work it has undertaken on departmental and agency reporting under the *Environment and Biodiversity Conservation Act 1999*) and the professions.<sup>164</sup> This approach would have the advantage of enabling refinement of the guidelines over time as preparers gain greater experience in the practicalities of such reporting.

Another respondent would accept additional guidance around ASX Corporate Governance Council Principles 3 and 7, to be developed by industry itself, not by the ASX, and to sit outside the Principles.<sup>165</sup>

One respondent supported guidance in accounting standards as a supplement to certain mandatory reporting requirements.<sup>166</sup>

### 2.6.3 Option 3: Expanded exchange-based reporting

#### *Option 3A: 'If not, why not' reporting*

Some submissions supported an 'if not, why not' ASX reporting requirement.<sup>167</sup>

One of those submissions<sup>168</sup> favoured the ASX incorporating either the GRI reporting requirements or the UK OFR reporting requirements into its Corporate Governance Council guidelines.

It identified the following advantages of using the GRI:

- it is globally applicable and already has a strong presence in Australia
- representatives from Australian industry have played a key role in developing 'sector supplements' to the GRI guidelines, in particular for the financial services sector.

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<sup>164</sup> CPA Australia (Submission 56).

<sup>165</sup> AICD (Submission 43).

<sup>166</sup> J Raar (Submission 35).

<sup>167</sup> UniSuper (Submission 36), Ethical Investment Association (Submission 59).

<sup>168</sup> Ethical Investment Association (Submission 59).

It identified the following issues covered by the OFR that could be incorporated into the ASX guidelines:

- non-financial information relevant to assessing past results and future performance
- resources, principal risks and uncertainties that may affect the entity's long-term value
- the impact of the business on the environment, the entity's employees and social and community issues
- significant relationships with stakeholders that are likely to influence directly or indirectly the performance of the business and its value, and
- the impact of the entity's activities on society and communities.

Various submissions would support adding to the existing ASX requirements as a fallback position. One of those respondents, while opposing any additional reporting requirements, would accept additions to the current ASX reporting requirements, if considered absolutely necessary.<sup>169</sup> Another respondent proposed introducing new legislative reporting requirements, but would accept adding to the ASX requirements if new legislation were not possible.<sup>170</sup>

### ***Option 3B: Mandatory reporting***

One submission<sup>171</sup> supported the government asking the ASX (or, alternatively, ASIC<sup>172</sup>) to develop minimum mandatory reporting standards for companies that choose not to adopt a voluntary reporting framework (see above under *Option 1B: Voluntary with government support*).

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<sup>169</sup> J Overland (Submission 41).

<sup>170</sup> Public Interest Law Clearing House, Vic (Submission 22).

<sup>171</sup> St James Ethics Centre (Submission 33).

<sup>172</sup> See Option 4B.

## 2.6.4 Option 4: legislative reporting

### *General support*

Some submissions favoured a Corporations Act environmental and social reporting requirement, without specifying what form that requirement should take.<sup>173</sup>

### *Option 4A: if not, why not*

#### *New Corporations Act provisions*

Various submissions proposed ‘if not, why not’ reporting requirements to be included in the Corporations Act:

- *disclosure of corporate policies*: one submission proposed that public companies and large proprietary companies make publicly available policies, manuals and other statements of the company’s practices that the company considers relevant to corporate social responsibility<sup>174</sup>
- *adoption of GRI*: one submission supported requiring GRI reporting under an expanded s 299(1)(f).<sup>175</sup>

#### *New Corporations Regulations provisions*

One submission proposed that the Corporations Act require reporting against a general framework to be specified by the Minister in the regulations and recommended that this framework incorporate as many elements of GRI as are appropriate.<sup>176</sup>

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<sup>173</sup> Corporate Law and Accountability Research Group (Submission 21) (the main concern of this submission was environmental reporting), M Nehme (Submission 25).

<sup>174</sup> Public Interest Law Clearing House, Vic (Submission 22), which proposed a new s 323DC.

<sup>175</sup> Australian Conservation Foundation (Submission 34).

<sup>176</sup> Public Interest Law Clearing House, Vic (Submission 22).

### Option 4B: mandatory

#### Corporations Act

Submissions supported various mandatory Corporations Act reporting options:

- *Disclosure of corporate policies*: require directors to consider a statutorily defined list of factors (including social and environmental factors) when making any decisions that affect the company's operations in a significant way and to document in the company's board minutes that they have done so.<sup>177</sup> The specific factors to be considered by a particular company would depend on matters such as its size, industry and location
- *Industry-based disclosure*: stipulate industry-based reporting standards.<sup>178</sup> This respondent considered that companies should report:
  - the strategy for the industry and how their particular approach fits in with the broader industry strategy
  - the end-of-period comparison of actual performance with the specified industry stance
- *Regulatory non-compliance*: replace the current requirement in s 299(1)(f) that the directors' annual report include details of performance in relation to environmental regulation with a requirement to include details of all non-compliances during the financial year, along the following lines:<sup>179</sup>

give details on any prosecutions, fines, notices, or directions by regulators, or voluntary agreements with regulators, as a result of actual, or potential, non-compliance with occupational health and safety, environmental, employment or trade practices law, or other regulation, applicable to the entity's activities.

For the purposes of this section, information should be reported for all operations, sites or activities for which the

<sup>177</sup> A Papamatheos (Submission 31).

<sup>178</sup> J Raar (Submission 35).

<sup>179</sup> AMP Capital Investors (Submission 58). This respondent favoured this expansion on the basis that meeting legal requirements is the minimum standard set by the community for a company's corporate responsibility and therefore a measure to assess whether directors are meeting their duties.

entity has a controlling interest or operates on behalf of other entities, whether or not there is ownership component

- *GRI*: adopt GRI as the mandatory reporting framework<sup>180</sup>
- *OFR type guidelines*: base the statutory disclosure requirements on the UK operating and financial review<sup>181</sup>
- *Human rights reporting*: adopt specific human rights disclosure requirements, namely:
  - *compliance with duty*—impose a duty on companies to ensure the protection of human rights and require annual reports to include a statement of compliance with that duty.<sup>182</sup> This would overcome the problem with the OECD Guidelines that companies can endorse the Guidelines without being required to report on their progress in delivering on them
  - *reporting on human rights risk factors*—require annual reports to include a statement on the level and nature of human rights risks that the companies face through their corporate activities. This should use a standardised list of industry types (such as that utilised by the Australian Bureau of Statistics) and geographic areas of operation.

One submission<sup>183</sup> supported the government asking ASIC (or, alternatively, the ASX<sup>184</sup>) to develop minimum mandatory reporting standards for companies that choose not to adopt a voluntary reporting framework (see above under *Option 1B: Voluntary with government support*).

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<sup>180</sup> T Heesh (Submission 27), NSW Young Lawyers (Submission 44), RepuTex (Submission 47). AICD (Submission 43) specifically opposed mandating adoption in Australia of the GRI or any other reporting framework (for instance, the UK OFR). In particular, that respondent saw the Australian Management Discussion and Analysis as a good approximation for the OFR.

<sup>181</sup> Australian Centre for Corporate Social Responsibility (Submission 37), AMP Capital Investors (Submission 58).

<sup>182</sup> Amnesty International Australia (Submission 54).

<sup>183</sup> St James Ethics Centre (Submission 33).

<sup>184</sup> See Option 3B.

### *Industry-specific legislation*

Some submissions<sup>185</sup> said that any need for additional disclosure in a particular industry should be dealt with in specific-purpose legislation or legislation specific to the particular industry.

One of those respondents<sup>186</sup> added the further qualifier that even this specific legislation should only be enacted if there is a clear call from the investment community. That respondent cautioned against expanding general reporting requirements, as:

- many shareholders are finding the size and complexity of annual reports inaccessible
- generalised reporting requirements tend to lead to formulaic disclosure, which is not informative or useful.

### *Other legislation*

One submission favoured the *Energy Efficiency Opportunities Act 2006*, which imposes new disclosure requirements on energy usage by the largest Australian companies.<sup>187</sup>

### *Exemption from reporting requirement*

One submission considered that insolvency administrators should be expressly excluded from any mandatory reporting requirement.<sup>188</sup>

## **2.7 Content of environmental and social reports**

### **2.7.1 Overview**

Reporting requirements can be:

- prospective, stating a company's strategy for achieving environmental and social goals and/or

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<sup>185</sup> WA Chamber of Commerce and Industry (Submission 48), Law Council of Australia (Submission 60).

<sup>186</sup> Law Council of Australia (Submission 60).

<sup>187</sup> Ethical Investment Association (Submission 59).

<sup>188</sup> Law Council of Australia (Submission 28). Symes (Submission 52) emphasised the usefulness of sustainability reports for insolvency administrators.

- historical, stating what a company has done to meet environmental and social goals

and the reporting, whether prospective or historical, can be quantitative or qualitative.

## 2.7.2 Possible specific requirements

The submissions identify a wide range of possible social and environmental reporting areas, such as:

### *Donations*

- charitable donations and any links between directors and charities, to be disclosed as related party transactions<sup>189</sup>

### *Legal compliance*

- material non-compliance with Australian law<sup>190</sup>—particularly breaches of environmental and OH&S regulations, or criminal conduct
- material non-compliance with overseas laws<sup>191</sup>
- material non-compliance with international human rights and labour standards,<sup>192</sup> such as the *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003)<sup>193</sup>

### *Government relationships*

- political donations<sup>194</sup>
- subsidies and export finance<sup>195</sup>

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<sup>189</sup> Australian Shareholders' Association (Submission 3).

<sup>190</sup> Australian Shareholders' Association (Submission 3), Australian Conservation Foundation (Submission 34), AMP Capital Investors (Submission 58).

<sup>191</sup> Brotherhood of St Laurence (Submission 10), Australian Conservation Foundation (Submission 34), AMP Capital Investors (Submission 58).

<sup>192</sup> L Byrnes (Submission 9), Brotherhood of St Laurence (Submission 10), Human Rights Law Resource Centre (Submission 11).

<sup>193</sup> Human Rights Law Resource Centre (Submission 11).

<sup>194</sup> Australian Shareholders' Association (Submission 3).

<sup>195</sup> Brotherhood of St Laurence (Submission 10).

### *Business processes*

- supply chains<sup>196</sup>—names or locations of major partners, clients and suppliers
- external processes (such as consultations with stakeholders)<sup>197</sup>
- community relations and impacts<sup>198</sup>
- how decision-making and strategy are informed by corporate social responsibility considerations<sup>199</sup>
- policies and procedures<sup>200</sup>

### *Environmental*

- resource use—electricity and water use and industry-specific non-renewable inputs<sup>201</sup>
- emissions—carbon dioxide,<sup>202</sup> air, land and water discharge pollutants or general environmental impacts.<sup>203</sup>

Reporting under these criteria could be subject to minimum thresholds, with companies below the threshold exempt from reporting.<sup>204</sup>

### **2.7.3 Scope of requirements**

Some submissions questioned how far some reporting requirements might extend, for instance:

- would a requirement for a company to disclose its supply chains require it to make disclosures about all possible participants in

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<sup>196</sup> Brotherhood of St Laurence (Submission 10), Environment Institute of Australia and New Zealand (Submission 15), AICD (Submission 43).

<sup>197</sup> Brotherhood of St Laurence (Submission 10), B Horrigan (Submission 12).

<sup>198</sup> NSW Young Lawyers (Submission 44).

<sup>199</sup> B Horrigan (Submission 12).

<sup>200</sup> Public Interest Law Clearing House, Vic (Submission 22).

<sup>201</sup> L Byrnes (Submission 9), Brotherhood of St Laurence (Submission 10), Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44), Ethical Investment Association (Submission 59).

<sup>202</sup> L Byrnes (Submission 9), Australian Conservation Foundation (Submission 34).

<sup>203</sup> Brotherhood of St Laurence (Submission 10), NSW Young Lawyers (Submission 44).

<sup>204</sup> Australian Conservation Foundation (Submission 34).

the supply chain, such as the supplier of energy to the company<sup>205</sup>

- would a requirement for environmental disclosure require disclosure about the full lifecycle of the product many years into the future<sup>206</sup>
- would there be any geographic limitations on the information that a company is required to report?<sup>207</sup>

#### 2.7.4 General frameworks

Many existing guidelines cover each of the four possible types of reporting (prospective/quantitative, prospective/qualitative, historical/quantitative and historical/qualitative) and combine some or all of the content areas in various ways.

Existing frameworks include:

- internationally accepted reporting guidelines, such as the GRI<sup>208</sup>
- guidelines specified in industry standards
- guidelines stipulated in the listing rules or legislation.

They provide a degree of standardisation that allows for national and international comparison of corporate environmental and social performance.

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<sup>205</sup> CPA Australia (Submission 56).

<sup>206</sup> CPA Australia (Submission 56).

<sup>207</sup> J Raar (Submission 35).

<sup>208</sup> The respondents that supported the GRI as a reporting framework, whether in the legislation, in exchange listing rules or as a voluntary framework, were Public Interest Law Clearing House, Vic (Submission 22), ECOsteps (Submission 23), T Heesh (Submission 27), Ernst & Young (Submission 29), Credit Union Industry Association (Submission 32), Australian Conservation Foundation (Submission 34), Lend Lease (Submission 39), National Australia Bank (Submission 45), Reputex (Submission 47), CPA Australia (Submission 56). Reasons given for supporting the GRI were that it can be adapted by industry sector and is in use around the world and would therefore involve lower additional compliance costs for global companies who already use it.

## 2.8 Who should be required to report

### 2.8.1 Companies

Submissions differed on which entities should be subject to any reporting obligation. Possibilities included:

- large companies only<sup>209</sup>
- listed companies<sup>210</sup>
- public and large proprietary companies<sup>211</sup>
- all companies of a particular size or engaged in particular businesses<sup>212</sup>
- the largest 500 companies, whether listed or unlisted, or, alternatively, companies involved in industries with a risk of significant environmental and social impacts.<sup>213</sup> In particular, this respondent considered that subsidiaries of foreign companies should be covered by any reporting requirement
- larger companies determined on the basis of income, capitalisation, expenditure and asset values.<sup>214</sup>

One reason given for favouring reporting by larger companies only is the greater impact those companies have on the community and the environment.<sup>215</sup> Another argument is that larger companies are better able to bear the cost of reporting.

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<sup>209</sup> Environment Institute of Australia and New Zealand (Submission 15), Public Interest Law Clearing House, Vic (Submission 22), Chartered Secretaries Australia (Submission 26), NSW Young Lawyers (Submission 44), RepuTex (Submission 47).

<sup>210</sup> RepuTex (Submission 47).

<sup>211</sup> Public Interest Law Clearing House, Vic (Submission 22).

<sup>212</sup> NSW Young Lawyers (Submission 44).

<sup>213</sup> Australian Conservation Foundation (Submission 34).

<sup>214</sup> T Heesh (Submission 27).

<sup>215</sup> T Heesh (Submission 27).

## **2.8.2 Entities other than companies**

The submission that favoured requiring all companies of a particular size or engaged in particular businesses to report<sup>216</sup> acknowledged the argument for requiring all entities ‘whose activities have a significant environmental or social impact’ to provide reports on that impact, whether or not they are companies, but considered that the great majority of large or otherwise significant entities (in whose environmental and social activities the public would have an interest) are likely to be corporations.

On the other hand, a submission that favoured any further reporting being only voluntary opposed mandatory reporting for companies as it would create an incomplete picture, because partnerships, individuals and other non-corporate entities would not need to report.<sup>217</sup>

## **2.8.3 Phased approach**

One respondent<sup>218</sup> considered that a reporting requirement could be phased in. For instance, it could initially apply to the 500 largest companies, whether listed or unlisted, or, alternatively, companies involved in industries with a risk of significant environmental and social impacts.

## **2.9 Other aspects of reporting**

### **2.9.1 Frequency of reporting**

One submission suggested that companies subject to the reporting requirement should be required to report annually.<sup>219</sup>

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<sup>216</sup> NSW Young Lawyers (Submission 44).

<sup>217</sup> Credit Union Industry Association (Submission 32).

<sup>218</sup> Australian Conservation Foundation (Submission 34).

<sup>219</sup> NSW Young Lawyers (Submission 44).

### 2.9.2 Verification

There was considerable support for requiring that reports be verified,<sup>220</sup> as:

- verification by established auditing firms and consulting companies would add credibility and integrity to reports, as well as an additional layer of accountability<sup>221</sup>
- the increased reliability that should flow from verification would decrease reliance on enforcement by government regulators<sup>222</sup>
- verification would reduce the gap between internal and external information.<sup>223</sup>

One option would be to have the reports audited by professional, independent auditors.<sup>224</sup> Another submission suggested that government establish a verification scheme.<sup>225</sup>

One submission<sup>226</sup> considered that reports should be externally verified, but suggested that this be done by disclosure (apparently on a voluntary basis) of whether the report has been verified. Stakeholders could then take into account any lack of verification.

### 2.9.3 Form of reports

For maximum accessibility, reliability and comparability, submissions suggested that reports should have the following features.

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<sup>220</sup> T Wilson (Submission 8), B Horrigan (Submission 12), Environment Institute of Australia and New Zealand (Submission 15), M Nehme (Submission 25), T Heesh (Submission 27), St James Ethics Centre (Submission 33), NSW Young Lawyers (Submission 44), RepuTex (Submission 47), ASIC (Submission 55). The Australian Conservation Foundation (Submission 34) said that mandatory reports should be considered part of the directors' report for the purposes of audit.

<sup>221</sup> RepuTex (Submission 47).

<sup>222</sup> Australian Conservation Foundation (Submission 34).

<sup>223</sup> J Raar (Submission 35).

<sup>224</sup> NSW Young Lawyers (Submission 44).

<sup>225</sup> Human Rights Law Resource Centre (Submission 11).

<sup>226</sup> ABA (Submission 49).

### *Format*

Reports should be in a consistent format. In particular, the GRI would be ‘a convenient and widely accepted framework’, but if a domestic (though less comprehensive) alternative is sought, compliance with Principle 10 and Recommendation 10.1 from the ASX Principles could be made mandatory.<sup>227</sup> [Under the November 2006 Corporate Governance Council draft amendments, the reporting aspects of Principle 10 have been moved under Principle 7.]

### *Narrative or quantitative reporting*

Some submissions<sup>228</sup> said that information on the environmental and social performance of companies should be in a quantitative form where possible.

One of those submissions<sup>229</sup> said that this would:

- reduce subjectivity
- aid comparison of performance over time and on a cross-sectional basis between companies, and
- enhance the scope for independent assurance.

It noted that the GRI draft G3 guidelines [subsequently introduced in October 2006] included a wider and more comprehensive range of metrics. However, particular dimensions of performance are best captured and encapsulated in narrative comment. The relevant test should be user utility and comprehension.

Another submission opposed prescribing criteria for narrative disclosures.<sup>230</sup>

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<sup>227</sup> NSW Young Lawyers (Submission 44).

<sup>228</sup> CPA Australia (Submission 56), J Raar (Submission 35).

<sup>229</sup> CPA Australia (Submission 56).

<sup>230</sup> Hermes Pension Management Ltd, UK (Submission 38).

## 2.9.4 Publication of relevant documentation

### *Sustainability reports*

Some submissions favoured including environmental and social reports as part of a company's annual reports.<sup>231</sup> One of those submissions said that, if this was not done, the reports should be posted on the company's website at the end of each financial year.<sup>232</sup>

### *Other policy documents*

One submission proposed that documentation relating to adherence to socially responsible practices be made publicly available, for instance, on the company's website.<sup>233</sup>

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<sup>231</sup> Public Interest Law Clearing House, Vic (Submission 22), NSW Young Lawyers (Submission 44).

<sup>232</sup> NSW Young Lawyers (Submission 44).

<sup>233</sup> Public Interest Law Clearing House, Vic (Submission 22).

## **3 Promotion of responsible practices**

*This chapter summarises the range of views in submissions on possible ways further to encourage responsible business practices.*

*An abbreviated version of this summary is found in Section 5.8 of the Advisory Committee report **The social responsibility of corporations** (December 2006).*

### **3.1 Terms of reference**

The terms of reference include:

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

### **3.2 Summary**

The submissions largely focus on government action in this area. The suggestions in submissions on possible government approaches are covered in Section 3.3 below.

The submissions also refer to ways that exchanges and the community generally could encourage socially and environmentally responsible business practices. These topics are covered in Sections 3.4 and 3.5, respectively, below.

### **3.3 Government action**

#### **3.3.1 Encouragement**

##### *Provide information*

The Government could provide guidance and make information on environmental and social matters publicly available, for instance on

a website.<sup>234</sup> Several government websites already do this, for instance, those for the Department of Environment and Heritage and the Prime Minister's Community Business Partnership.<sup>235</sup>

Some submissions suggested that government officials could incorporate environmental and social information in advice they give to industry.<sup>236</sup> In particular, one of those submissions<sup>237</sup> said that:

- Australia's trade commissioners should include information about corporate social responsibility and compliance with local laws and international standards in trade development and investment advice that they offer to potential foreign investors
- Austrade and the Export Finance and Insurance Corporation could assist firms, particularly small and medium-sized enterprises, to understand the realities of sustainable and socially responsible investment in developing countries.

### *Encourage discussion of environmental and social issues*

Some submissions suggested that the Government should encourage discussion of environmental and social issues.<sup>238</sup>

### *Promote internationally agreed environmental and social standards*

Some submissions<sup>239</sup> said that the Government should promote uniform guidelines such as the OECD Guidelines for Multinational Enterprises, the UN Global Compact, the ILO Standards, UN human rights norms and the Extractive Industry Transparency Initiative.

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<sup>234</sup> NSW Young Lawyers (Submission 44) (this submission cites websites in Germany, the UK and Canada), Business Council of Australia (Submission 57). The RepuTex submission to the Parliamentary Joint Committee, incorporated by reference into RepuTex (Submission 47), drew attention to UK government websites.

<sup>235</sup> [www.deh.gov.au](http://www.deh.gov.au), [www.partnerships.gov.au](http://www.partnerships.gov.au)

<sup>236</sup> Brotherhood of St Laurence (Submission 10), NSW Young Lawyers (Submission 44).

<sup>237</sup> Brotherhood of St Laurence (Submission 10).

<sup>238</sup> Brotherhood of St Laurence (Submission 10), B Horrigan (Submission 12), Institute of Chartered Accountants in Australia (Submission 30), Australian Centre for Corporate Social Responsibility (Submission 37), ANZ (Submission 40), National Australia Bank (Submission 45), RepuTex (Submission 47), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>239</sup> Brotherhood of St Laurence (Submission 10), RepuTex (Submission 47), ABA (Submission 49), AMP Capital Investors (Submission 58).

### ***Encourage participation in existing environmental and social initiatives***

Some submissions suggested the need for policies or incentives to encourage participation in existing indices.<sup>240</sup> Another submission favoured government supporting particular industry or community initiatives.<sup>241</sup> Other submissions favoured government facilitating environmental and social partnerships between itself and industry or between private and community sectors.<sup>242</sup>

### ***Promote sustainable practices***

Some submissions suggested that government should promote ecologically sustainable development and business strategies.<sup>243</sup> Another submission<sup>244</sup> suggested that government lend its support to initiatives such as Computershare's E Tree, which promotes electronic communications between companies and their shareholders, limiting the need for paper communications. The CLERP 9 electronic communications legislation helped to facilitate this initiative.

Alternatively, governments could reach agreements with industry to implement good environmental and social practices.<sup>245</sup>

### ***Encourage industry associations to promote environmental and social standards***

One submission suggested that the Government should encourage industry associations to develop membership criteria that include ethical business practices and a functioning corporate social responsibility framework.<sup>246</sup> Another respondent suggested that government should support the industry-based development of

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<sup>240</sup> Human Rights Law Resource Centre (Submission 11), St James Ethics Centre (Submission 33).

<sup>241</sup> Law Council of Australia (Submission 60).

<sup>242</sup> B Horrigan (Submission 12), RepuTex (Submission 47), Amnesty International Australia (Submission 54).

<sup>243</sup> B Horrigan (Submission 12), RepuTex (Submission 47), Amnesty International Australia (Submission 54), Business Council of Australia (Submission 57), AMP Capital Investors (Submission 58).

<sup>244</sup> AICD (Submission 43).

<sup>245</sup> NSW Young Lawyers (Submission 44).

<sup>246</sup> Brotherhood of St Laurence (Submission 10).

effective measurement of corporate social responsibility type activities.<sup>247</sup>

Another submission said that legislative backing should be given to ‘enforced self-regulation’, that is, giving the force of law to industry-based private regulation<sup>248</sup> (see below under [3.3.5 Regulation](#)).

### *Awards*

Some submissions suggested greater government involvement in sustainability awards.<sup>249</sup> One of those submissions suggested that the Government should ensure that industry awards, corporate ratings and other mechanisms that identify companies as examples of ‘best practice’ give rigorous attention to evidence of a working environmental and social framework.<sup>250</sup>

## **3.3.2 Government policy**

### *Co-ordinated environmental and social policy*

Some submissions favoured the Government setting up a detailed policy framework for the promotion of environmental and social issues both by government itself and by industry.<sup>251</sup> This framework might include the Government networking or co-ordinating expertise and guidance in this area, for instance, co-ordinating material to inform Australia’s response to various ongoing international standard-setting initiatives relating to environmental and social issues.

### *Minister for Corporate Social Responsibility*

Some submissions favoured the Government co-ordinating its approach to this area and appointing a Minister for Corporate Social

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<sup>247</sup> Credit Union Industry Association (Submission 32).

<sup>248</sup> T Wilson (Submission 8).

<sup>249</sup> Brotherhood of St Laurence (Submission 10), M Nehme (Submission 25), National Australia Bank (Submission 45), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>250</sup> Brotherhood of St Laurence (Submission 10).

<sup>251</sup> B Horrigan (Submission 12), RepuTex (Submission 47).

Responsibility<sup>252</sup> or a National Corporate Responsibility Commissioner.<sup>253</sup>

### *Set an example*

Some submissions said that government departments and the Federal Government as a whole should encourage corporate responsibility by meeting environmental and social standards and reporting on these aspects of their activities.<sup>254</sup>

Another suggestion was to adopt a ‘Genuine Progress Indicator’ to replace Gross Domestic Product as the preferred indicator of economic progress.<sup>255</sup> That respondent said:

the clean-up of a contaminated site generates employment for environmental remediation experts, which shows up as a positive contribution to the GDP. However, none of the ills attributable to the contaminated site—such as the waste of resources that could be put to more productive uses, and the damage to the health of individuals and ecosystems—are taken into consideration.

Another submission suggested that the Government carry out an audit of its activities that complement or support corporate social responsibility.<sup>256</sup> The submission pointed to a similar recent exercise carried out by the US Government Accountability Office, which issued its report in August 2005.

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<sup>252</sup> B Horrigan (Submission 12), IAG (Submission 16), Australian Centre for Corporate Social Responsibility (Submission 37), RepuTex (Submission 47).

<sup>253</sup> Australian Conservation Foundation (Submission 34). Also, NSW Young Lawyers (Submission 44) noted that Canada has created a Commission of the Environment and Sustainable Development to monitor corporate responsibility in Canada.

<sup>254</sup> IAG (Submission 16), Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44), RepuTex (Submission 47), Law Council of Australia (Submission 60). The latter submission noted that, in Canada, federal departments are required to produce sustainable development strategies every three years and table them in Parliament.

<sup>255</sup> Australian Conservation Foundation (Submission 34).

<sup>256</sup> Australian Centre for Corporate Social Responsibility (Submission 37).

### *Invest in and publish research*

Some submissions suggested that the Government could invest in and publish research into the contribution of corporate social responsibility to corporate success.<sup>257</sup>

For instance, the Government could monitor the effects of economic behaviour on the environment and our society in a more balanced, systematic way and incorporate those measurements better into policy-making.<sup>258</sup>

### *Dealings with business*

Some submissions suggested that government could make environmental and social issues a criterion in deciding whether to have dealings with particular organizations, for instance:

- when inviting tenders for government work<sup>259</sup>
- when entering into procurement contracts<sup>260</sup>
- when entering into public/private partnerships.<sup>261</sup>

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<sup>257</sup> B Horrigan (Submission 12), Australian Conservation Foundation (Submission 34), Australian Centre for Corporate Social Responsibility (Submission 37), ANZ (Submission 40), ABA (Submission 49), Business Council of Australia (Submission 57).

<sup>258</sup> Australian Conservation Foundation (Submission 34).

<sup>259</sup> Human Rights Law Resource Centre (Submission 11), Australian Conservation Foundation (Submission 34), RepuTex (Submission 47), J Howe (Submission 50).

<sup>260</sup> Brotherhood of St Laurence (Submission 10), Human Rights Law Resource Centre (Submission 11), B Horrigan (Submission 12), Public Interest Law Clearing House, Vic (Submission 22), M Nehme (Submission 25), Australian Conservation Foundation (Submission 34), RepuTex (Submission 47), J Howe (Submission 50).

For instance, RepuTex (Submission 47) suggested that governmental bodies could reward sustainable business practices by giving preferential access to contracts and tenders to partners and contractors that meet high sustainability standards (for instance, across governance, environmental, social and workplace practices areas).

J Howe (Submission 50) drew attention to the Victorian Government's 'Ethical Purchasing Policy', which 'requires suppliers of goods and services to demonstrate "to the reasonable satisfaction of the government buyer" that the contracting or tendering entity is meeting "its obligations to its employees under *applicable industrial instruments and legislation* at the time a contract is awarded and continues to meet such obligations during the term of that contract"': *The Victorian Government's Ethical Purchasing Policy: Supporting Fair and Safe Workplaces* (Department of Treasury and Finance, State of Victoria, December 2003).

<sup>261</sup> Brotherhood of St Laurence (Submission 10), B Horrigan (Submission 12), J Howe (Submission 50).

### *Education*

Some submissions favoured government participating in or supporting educational initiatives as a way of promoting environmental and social standards and goals.<sup>262</sup>

One of those submissions proposed that the Government work with relevant professional bodies to develop an appropriate accreditation/training program to deal with environmental and social issues.<sup>263</sup>

### *Make environmental and social matters a factor in international negotiations*

One submission suggested that the Government should seek to include in free trade agreements and other bilateral investment mechanisms social and environmental clauses and recognition of human rights.<sup>264</sup>

### *Refer to international instruments in policy documents*

One submission suggested that the Government should refer to the OECD Guidelines for Multinational Enterprises in all relevant government policy documents.<sup>265</sup>

## **3.3.3 Financial**

### *Taxation measures*

Some submissions suggested that the Government should initiate an inquiry into environmental and social taxation, with a view to:

- identifying and quantifying perverse subsidies at both the federal and state levels

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<sup>262</sup> Environment Institute of Australia and New Zealand (Submission 15), M Nehme (Submission 25), AICD (Submission 43), NSW Young Lawyers (Submission 44), National Australia Bank (Submission 45), ABA (Submission 49), Amnesty International Australia (Submission 54), Business Council of Australia (Submission 57).

<sup>263</sup> Environment Institute of Australia and New Zealand (Submission 15).

<sup>264</sup> Brotherhood of St Laurence (Submission 10).

<sup>265</sup> Brotherhood of St Laurence (Submission 10).

- shifting taxation from desirable activities, such as work, to undesirable activities, such as pollution and resource consumption, and
- evaluating structural options for embedding environmental and social considerations better into taxation and spending policy development.

### *Removing impediments*

Some submissions suggested encouraging sustainable corporate behaviour by eliminating perverse subsidies.<sup>266</sup> According to those respondents:

- under the fringe benefits tax concessions for use of company cars, the more one drives a company car, the lower the tax rate applied to the fringe benefit. Also, company cars need not be used at all for business purposes, and it is common practice for executives to receive additional cars for use by family members
- numerous concessions rewarding fossil fuel use, including concessional rates on aviation fuel and rebates for off-road diesel fuel use, result in greater greenhouse pollution
- the exemption of water from the GST, even when used for commercial purposes, discourages water conservation measures.

One of those submissions<sup>267</sup> suggested removing tax impediments to socially and environmentally desirable behaviour, arguing that:

- the current fringe benefits tax (FBT) law provides employers with an exemption for on-site childcare, but not childcare at third party facilities
- some businesses have reported difficulties with taxation arrangements for foundations that they have established for the benefit of the community, in particular in gaining income tax exempt charity endorsement or deductible gift recipient status for corporate foundations.

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<sup>266</sup> Australian Conservation Foundation (Submission 34), Business Council of Australia (Submission 57).

<sup>267</sup> Business Council of Australia (Submission 57).

### *Providing incentives*

Some submissions suggested providing tax incentives to promote sustainability.<sup>268</sup> These could include:

- tax breaks for sustainable practices
- phasing out capital gains tax over some long period of time, to encourage long-term investment and business planning
- carbon taxes.

Some submissions<sup>269</sup> supported an approach adopted in the Netherlands under which the government gives tax advantages to ‘fiscal green funds’ for certified ‘green’ projects, a concept successfully implemented on a large scale. The funds are set up by Dutch banks and attract primarily retail investors. Interest paid to investors from the fund is tax-free. According to these respondents, the tax advantage is split three ways:

- investors receive an interest rate somewhat lower than market rates, but still earn a better-than-market return because of the tax-free status of interest payments
- green businesses have access to lower interest rates than they could otherwise receive, since the investors are willing to accept lower rates of return, and
- banks are able to charge somewhat higher fees, to cover higher transaction costs and risk.

The scheme could be applied to clean energy, sustainable land management and residential and commercial building efficiency.

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<sup>268</sup> B Horrigan (Submission 12), M Nehme (Submission 25), Chartered Secretaries Australia (Submission 26), Australian Conservation Foundation (Submission 34), J Howe (Submission 50). However, J Hazelton (Submission 18) expressed reservations about whether taxation was always successful in achieving this purpose.

<sup>269</sup> Australian Conservation Foundation (Submission 34), NSW Young Lawyers (Submission 44).

### *Financial and market incentives other than tax*

Possible non-tax financial incentives suggested by submissions were:

- charging fees for unsustainable business practices<sup>270</sup>
- giving grants and subsidies<sup>271</sup>
- providing loan guarantees<sup>272</sup>
- targeting export finance and insurance schemes to those companies that can demonstrate ethical business practices that adhere to social, developmental, environmental, cultural and human rights standards<sup>273</sup>
- allowing emissions trading.<sup>274</sup>

### **3.3.4 Certification**

Some submissions advocated a government role in developing or verifying standards for measuring corporate behaviour, as discussed in this section.

#### *Indices and benchmarks*

Some submissions<sup>275</sup> pointed to alleged factors undermining the credibility of privately compiled indices:

- bias<sup>276</sup>
- conflicts of interest in the organization compiling the indices<sup>277</sup>
- conflicts of interest in organizations from which information is sought to compile indices.<sup>278</sup>

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<sup>270</sup> M Nehme (Submission 25), Australian Conservation Foundation (Submission 34), RepuTex (Submission 47).

<sup>271</sup> M Nehme (Submission 25), Australian Conservation Foundation (Submission 34), J Howe (Submission 50).

<sup>272</sup> M Nehme (Submission 25).

<sup>273</sup> Brotherhood of St Laurence (Submission 10).

<sup>274</sup> Australian Conservation Foundation (Submission 34), RepuTex (Submission 47).

<sup>275</sup> M Nehme (Submission 25), ANZ (Submission 40).

<sup>276</sup> M Nehme (Submission 25).

<sup>277</sup> M Nehme (Submission 25), ANZ (Submission 40).

Some submissions supported government guaranteeing the credibility of indices and/or benchmarks.<sup>279</sup>

One submission also drew attention to the potential problem of limited access to information contained in private indices.<sup>280</sup> Some submissions favoured government establishing its own performance indicators or benchmarks.<sup>281</sup> This would deal with the credibility and access problems.

### *Standards and labels*

One submission suggested that the Government should increase support for Australian Standard *AS 8003-2003 Corporate social responsibility* by developing a certification program, with associated training and development support.<sup>282</sup>

Another submission suggested that the Government could adopt the voluntary Belgian practice of social labelling, under which a company can acquire a label as long as it meets a number of criteria and is examined and approved by an accredited body. A company applying for the label for one of its products would have to submit information on all suppliers and subcontractors directly involved with the making of the product.<sup>283</sup>

### *Verification scheme*

One submission said that the Government should consider providing resources for the establishment and operation of a standards and verification scheme based on the *Draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003), which provides certification to corporations compliant with those Norms.<sup>284</sup>

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<sup>278</sup> M Nehme (Submission 25).

<sup>279</sup> ANZ (Submission 40). One respondent, M Nehme (Submission 25), states that indices need 'to be impartial and to be independently funded'.

<sup>280</sup> M Nehme (Submission 25).

<sup>281</sup> B Horrigan (Submission 12), Environment Institute of Australia and New Zealand (Submission 15), AICD (Submission 43).

<sup>282</sup> Australian Centre for Corporate Social Responsibility (Submission 37).

<sup>283</sup> NSW Young Lawyers (Submission 44).

<sup>284</sup> Human Rights Law Resource Centre (Submission 11).

### *Co-ordinating voluntary certification initiatives*

#### *GRI*

One submission supported greater Australian involvement in developing relevant sector GRI reporting requirements and would support the Government if it were to establish a nationally co-ordinated forum on this.<sup>285</sup> That forum could discuss increasing the comparability of non-financial reports.

#### *CRI*

Some submissions favoured government giving support to the Corporate Responsibility Index.<sup>286</sup> One of those submissions advocated government financial support for an expansion of that Index.<sup>287</sup>

#### *Independent auditing*

Governments could encourage companies to have their environmental and social performance independently audited. For instance, the German federal government offers benefits and incentives to apply a European community scheme called the European eco-management and audit scheme (EWAS), which includes agreeing to environmental supervision, reporting requirements, notification duties regarding corporate organization and emission measurements.<sup>288</sup>

### **3.3.5 Regulation**

One submission<sup>289</sup> recommended the following legislative changes:

- provide for a voluntary code of conduct in corporate constitutions, with special provision for listed companies, and strengthen s 140 (effect of constitution and replaceable rules) to allow for the code's enforcement, ensuring 'proper' conduct is defined by reference to the code
- ensure the derivative action and the business judgment rule take this sense of 'proper' into account.

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<sup>285</sup> Lend Lease (Submission 39).

<sup>286</sup> Ernst & Young (Submission 29), St James Ethics Centre (Submission 33).

<sup>287</sup> St James Ethics Centre (Submission 33).

<sup>288</sup> NSW Young Lawyers (Submission 44).

<sup>289</sup> D Wishart (Submission 6).

Another submission recommended that all public companies (as defined in s 9 of the Corporations Act) and all large proprietary companies (as defined in s 45A(3) of the Corporations Act) be required to adopt and make publicly available a code of conduct or explain why not.<sup>290</sup>

Other suggestions were:

- give legislative backing to ‘enforced self-regulation’, that is, giving the force of law to industry-based private regulation<sup>291</sup>
- include in the legislation descriptive provisions to operate by way of guiding principles<sup>292</sup>
- retain the 100 shareholder element of the 5% or 100 shareholder rule in s 249D of the Corporations Act, to maintain a mechanism by which shareholders can place before general meetings resolutions relating to the company’s social and environmental performance<sup>293</sup>
- require companies to recover performance-based executive compensation awarded during the relevant period where full financial provision for environmental and social liabilities incurred by the company is not made at the time the actions or omissions leading to such liabilities occur, unless they obtain from ASIC a waiver, which can be granted only if there is no reasonable prospect of a significant recovery of the funds<sup>294</sup>

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<sup>290</sup> Public Interest Law Clearing House, Vic (Submission 22). The submission suggests that the legislation should give examples of what should be contained in the code.

<sup>291</sup> T Wilson (Submission 8), B Horigan (Submission 12).

<sup>292</sup> L Byrnes (Submission 9).

<sup>293</sup> Public Interest Law Clearing House, Vic (Submission 22). This element would be removed if the Corporations Amendment Bill (No 2) 2006 is enacted. The Advisory Committee’s report *Shareholder Participation in the Modern Listed Public Company* (June 2000) Recommendation 2 recommended abolishing the 100 member rule in relation to calling an extraordinary general meeting. However, that report also supported retaining the current statutory right of 100 members to place proposals on the agenda of a general meeting (s 249P). Another submission pointed to the key role of shareholders in encouraging companies to adopt responsible business practices: Hermes Pension Management Ltd, UK (Submission 38).

<sup>294</sup> Australian Conservation Foundation (Submission 34).

- provide a legal remedy for persons injured through a breach of the United Nations Human Rights Norms for Business<sup>295</sup>
- 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 volunteering with community organisations.<sup>296</sup>

Suggestions involving taxation would also involve legislation (see *Taxation measures* in Section 3.3.3 above).

### 3.4 Exchange encouragement

One submission supported the ASX developing 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).<sup>297</sup>

Another submission<sup>298</sup> said:

In our experience market indices have not led to an improvement in standards of behaviour of disclosure as the requirements for inclusion in such indices tend to be extremely broad. Being excluded from such indices, by contrast, can have a substantial reputational impact.

### 3.5 Community action

#### 3.5.1 Consumer advocacy and mobilisation

One submission suggested that consumer movements could take action to encourage companies to focus attention on environmental and social issues.<sup>299</sup>

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<sup>295</sup> Australian Conservation Foundation (Submission 34).

<sup>296</sup> Business Council of Australia (Submission 57).

<sup>297</sup> Human Rights Law Resource Centre (Submission 11).

<sup>298</sup> Hermes Pension Management Ltd, UK (Submission 38).

<sup>299</sup> Human Rights Law Resource Centre (Submission 11).

### **3.5.2 Educational initiatives**

Some submissions said that universities and professional associations should incorporate environmental and social issues in their business courses and professional associations should include them in their certification requirements and continuing education courses.<sup>300</sup>

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<sup>300</sup> Environment Institute of Australia and New Zealand (Submission 15), Lend Lease (Submission 39).