CPA Australia

Submission to

Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into
Corporate Responsibility

October 2005

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Executive Summary

CPA Australia, the pre-eminent body representing the diverse interests of more than 105,000 finance, accounting and business advisory professionals working in the public sector, public practice, industry and commerce, academe and the not-for-profit sector, is pleased to make this submission.

More than 18,000 of our members hold company directorships, with a further 20,000 in positions of general manager and above including roles as CEO and CFO. CPA Australia is therefore well placed to provide its comments on the merit and potential ramifications for the Committee's deliberations concerning the emerging issues of corporate responsibility and the relationships with Triple-Bottom-Line reporting. Moreover, CPA Australia along with the University of Sydney continue to play major roles in researching and developing applied approaches to TBL reporting.

PREAMBLE

Over recent years Australian business, government and community have witnessed some unacceptable corporate conduct. Each incident reinforces a growing disconnect between the expectations of community and the practices of some corporations. However, each incident also serves to emphasise that inappropriate practices are not the norm, and the vast majority of today's business leaders regularly display high levels of competence and integrity.

A common concern arising from recent corporate 'misconduct' has been the impact of such conduct on individuals other than shareholders. The collapse of a corporation may hurt the financial position of a shareholder, but others such as employees and suppliers are often worse off. The community's perception of the role of the corporation has shifted to reflect its concern for the corporations' potential impact on the wider community. This PJCCFS inquiry reflects a growing expectation that Australia's corporate law and business practices must keep pace with changing community expectations.

CPA Australia has invested resources to gain an understanding of the following four key areas through leading edge research and policy focus on corporate responsibility. We would appreciate the opportunity to discuss our submission and research with the Committee.

Current legal framework

CPA Australia's review of the legal framework considers two primary concerns, firstly the framework within which the interests of stakeholders may be taken into account by the corporation and its directors, and secondly the wider framework of social and environmental law that dictates the practices of companies and directors.

The attached submission shows that our existing legal environment has the capacity to compel and encourage companies to act in ways that are better aligned with community expectations. This submission suggests that evolutionary reform of the corporate law is enough to balance the interests of business and community.

Capacity to reflect the interests of stakeholders

The following issues are relevant the current debate:

- there is no express limitation on a directors ability to consider the interests of stakeholders, however neither is there a duty to do so;
- directors have a duty to pursue the interests of the corporation which may extend to consideration of stakeholder interests and even the elevation of these interests above those of shareholders where this is consistent with the interests of the company as a whole; and
- only shareholders, along with the Regulator, currently have formal avenues to directly challenge or sanction directors decisions.

The role of the corporation within society has evolved considerably, but has retained key elements associated with the concept of incorporation. The corporation exists in perpetuity, can contract in its own right and by its existence creates a separation of management from ownership. The owners in return benefit from limited liability (in most cases).

Within this general framework the wider body of case law, statute and regulation has evolved to modify and control aspects of the corporation and its activities in line with the evolving use and at times abuse of the corporate form. The current corporate responsibility debate is an extension of this process.

The role of the company director has also evolved in case law and statute. Today the complex and unique interaction between the director and the company and by extension with shareholders are well defined. Directors bear ultimate responsibility for decision making within the corporation and are entrusted by shareholders as stewards of the corporation's ongoing success. Directors have both a fiduciary and a duty of care to the company.

One measure of true organisational value from a shareholder perspective is the company's long term profitability. This longer term perspective requires directors to deliberate on alternatives that will deliver short and long term gains and ensure the organisation is sustainable. By definition the latter demands directors to consider the impact of the corporation on the broader community and the holistic risks and benefits that alternative courses of action present.

Purpose and source of regulation

The purpose of the Corporations Act is to regulate the formation, operation and closure of corporations and role of its directors and officers. Its purpose is not to set environmental and social standards, nor to introduce a positive obligation on companies to behave in a particular way. Where there is a need to establish minimum standards of behaviour or to prescribe certain types of behaviour in relation to environmental, social or employment issues, it is more appropriate that these obligations are addressed through specific purpose legislation.

There is much evidence to support the voluntary endeavours of business achieve socially responsible outcomes without regulation or legislation. In addition bodies such as the Australian Stock Exchanges Corporate Governance Council has elevated corporations regard for the interests of stakeholders through its best practice guidelines thereby guiding companies as well as stakeholders.

We suggest creating a general duty on directors that is subject to interpretation will not meet community expectations. Specific outcomes required of directors need to be clearly defined before any obligation is placed on directions in this regard.

In summary, CPA Australia is of the view that proposals to extend the role of the Corporations Act to capture emerging environmental and social concerns would detract from existing pieces of legislation, the wider legal framework, and is unlikely to deliver quality outcomes for business and the Australian community.

Contemporary business practices

A growing number of Australian businesses are adopting responsible corporate behaviour and recognise the importance of engaging with a range of stakeholders broader than shareholders. It is essential that these voluntary endeavours be encouraged.

In August 2005 CPA Australia released *Sustainability – Practices, Performance and Potential* a research report undertaken by the University of Sydney. The research looked at sustainability reporting by Australian companies and clearly shows that its value and contribution to more informed stakeholders is undermined by the absence of a common reporting framework. Without a common basis to reporting, users are unable to compare information across time and across companies and so penalise or reward companies. This outcome is reflected in the failure of capital markets to value sustainability information and suggests that market forces are unlikely to drive future improvements to sustainability reporting and by association corporate practices.

Sustainability disclosures are the accessible outputs used in CPA Australia's research. CPA Australia does not assume that companies that do not issue sustainability/tbl information are not sensitive to their wider stakeholders' interests or have failed to understand the wider spectrum of business risk. However the research indicated a strong correlation between sustainability reporting and low probability of corporate distress . This relationship may suggest companies that issue sustainability reports are more aware of the wider range of risks that may impact on the business and also further demonstrates that the longer term and more holistic approach to enterprise risk managements rewards both shareholders and stakeholders.

The main finding is that the best efforts of individual companies cannot overcome markets' reluctance to value sustainability information. For business to realise the benefits of their endeavours, the entire sustainability reporting chain must be addressed – from the practices applied by business, to the capturing, measuring, disclosing of audited information to stakeholders including investors, and subsequently to the

ability and willingness of stakeholders and financial markets to appropriately value non-financial information and factor it into their decision making. Only part of this workload rests with Australian business.

A far greater responsibility rests with Australia's current myriad of standard setters, legislators and regulators at state and federal level. A structured and collective approach can determine meaningful and consistent improvements that balance the needs of business with the public's desire for increased accountability now and over time.

In particular there is a clear need to develop a robust social and environmental reporting framework that delivers quality, meaningful information that is subject to independent audit. CPA Australia, as business partner with the University of Sydney, is building part of this framework through a project to develop mechanisms for capturing, measuring and reporting social and environmental information. The project will enhance business' access to meaningful information for internal business decision making, and by extension external reporting.

Any local initiatives must also be mindful of international developments and facilitate international convergence towards an accepted reporting framework such as the Global Reporting Initiative (GRI).

Global trends

Today's corporations transcend national borders, and countries compete to attract increasingly mobile capital. For this reason Australia must consider the approaches adopted by other nations from two perspectives:

- to ensure Australia remains an attractive place for business, thereby ensuring we continue to attract capital investment and business activity to support the ongoing success of the Australian economy;

- to avoid disparate national approaches that multiply the compliance obligations for international businesses and which frustrate the comparison of activity between international companies.

CPA Australia will shortly release findings of an extensive review of more than a dozen countries from across the Asia pacific region that looks at the current regulatory environment for sustainability reporting. The study reviewed Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Philippines, Singapore, South Korea and Thailand.

The importance of CPA Australia's work lies in its consideration of frameworks outside the dominant economies of the US and EU. The study considers the steps countries within our financial services region are taking to address the same dilemma now confronting Australia.

The research confirms that the development of social an environmental reporting across the Asia Pacific region varies considerably. A range of initiatives are in place or in development, ranging from 'name and shame' to more structured reporting obligations:

- Only two countries do not have any obligations in place (mandatory, voluntary or guidance);
- Only 25 percent of countries surveyed have legislated mandatory reporting of social and environmental information by companies (3 of the 12 countries reviewed have specific mandatory requirements);
- Less than 20 percent of countries surveyed have existing legislative reporting obligations that companies' could extend to include social and environmental reporting (2 have general mandatory requirements);
- Guidance issued by interest groups or professional bodies is the most common way that companies are encouraged /assisted to report on social and environmental information (9 have specific recommendations and guidelines);
- Australia is the only country to have requirements across all categories, but this is not a measure of the quality of the requirements, rather a reflection of the fact that a range of parties are contributing to the development of social and environmental reporting in Australia.

The current status suggests that there is enough momentum and interest for Australia to not only learn from other jurisdictions within our region, but also to warrant a global effort from the accounting profession to better guide the capture, measurement and reporting of information. Such an approach would substantially reduce the prospect of competing frameworks and increase comparability across regions in much the same way as International Financial Reporting Standards are enabling a common global financial reporting language.

Public Expectations

The final component of CPA Australia's big picture analysis has been to consider the views of the Australian public including shareholders. Our Confidence In Corporate Reporting Research 2005 (CICR 2005) will be released publicly in coming months, and provides insights into the attitudes of individuals and their expectations of corporate conduct. The research captured the views of over 700 Australians (including 300 shareholders, 150 financial analysts and advisers, 200 company directors, CEOs and CFOs as well as 50 auditors) on a wide range of social and environmental issues and reflected the many ways Australians engage with corporations as employees, investors and consumers.

It is important to recognise that the public views captured in this research reflect their expectations. The challenge for business, professional bodies, legislators and regulators is to find practical ways to give effect to these expectations and so better align public and business interests.

The research revealed a number of important insights into the perceived position and influence of stakeholders:

- Nearly 9 out of 10 Australians and investors believe the interests of shareholders and other stakeholders should be of equal importance to a company;
- Nearly 9 out of 10 Australians and 8 out of 10 shareholders believe better management of a company's social and environmental concerns benefits shareholders; and
- Less than 4 out of 10 Australians and just on 4 out of 10 shareholders believe financial performance is more important than environmental and social concerns.

These outcomes suggest that the public and shareholders not only support, but also see benefits in company leaders considering the interests of a wider range of stakeholders and is an important endorsement in the context of the current regulatory debate.

In practice however, fewer Australians and shareholders believe company directors adequately balance the financial performance of the company with its social and environmental concerns. Less than half the Australians surveyed and 50 percent of shareholders agreed that company directors adequately balance these interests. In addition, the majority of Australians (51%) and shareholders (55%) do not believe that Australian company directors have adequate regard for the interest of all stakeholders.

These findings suggest Australian business leaders have a way to go to build this confidence with the public and shareholders, but also demand that we consider the environment within which business leaders operate and whether this impinges on their ability to do so.

Role of corporate responsibility reporting

CPA Australia's research shows strong public and shareholder recognition of the value of quality reporting by companies. Ninety-six percent of Australians and 94 percent of shareholders believe companies would be more sensitive to their social and environmental impacts it they were required to report on them. This view was similarly reflected amongst directors, CEOs ,CFOs (88%) and auditors (94%), and clearly identifies an important opportunity to improve the credibility of business practices through improved reporting.

While there is strong public (88%) and shareholder (86%) support for Government to mandate the reporting of companies' social and environmental reporting this is not reflected in the views of business leaders (53%). CPA Australia believes this reflects a valid business concern that mandatory reporting would not enhance the value of the information provided and introduce an unnecessary layer of regulation.

A further consideration is the need to develop appropriate audit processes with 86 percent of Australians, 88 percent of shareholders and 77 percent of company directors, CEO and CFOs agreeing that companies' social and environmental information is only worthwhile if it is subject to independent audit. This finding reinforces CPA Australia's earlier comments that enhancements to sustainability reporting must address the entire reporting chain and not simply disclosure by individual companies.

Need for education and guidance

There is significant opportunity to improve the application of the existing body of law through education, better guidance and more rigorous enforcement. A collective effort is warranted to deliver initiatives such as codes of conduct and related guidance that is an accepted benchmark for business.

CPA Australia also supports more rigorous enforcement of existing law. At present key areas of law are largely untested adding to business and stakeholder uncertainty. More active application of existing law would assist in filling in the gaps around the laws interpreted purpose and its practical application.

Comments of the Parliamentary Joint Committee Terms of Reference

Attachment 1 contains a comprehensive examination of the legal issues associated with the terms of reference for the inquiry into corporate responsibility. As summary of the recommendations is outlined below.

a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

It is important to draw a distinction between the legal responsibilities of company directors, their interaction with company stakeholders, and the concept of corporate social responsibility. There is sufficient scope within the law as it currently exists to allow directors to consider stakeholders other than shareholders and it is increasingly common for companies to do so.

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.

b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

Regard for the interests of stakeholders other than shareholders is essential to effective decision making within the modern business. It is therefore not a question of whether organisations should have regard, but rather how such stakeholder engagement should take place.

Companies that base their decisions on a more complete understanding of business risk are making more informed decisions and are more likely to achieve their short and long term objectives.

Any assumptions about business being conducted free from any regard for wider consequences are no longer tenable. Corporate behaviour has evolved to reflect a widening regard for stakeholder interests driven by increasing global pressures. The greater challenge is to ensure there is appropriate interaction between regulation and market mechanisms.

Insurance Australia Groups' Risk Radar for Smash Repairers is one example of a firm level initiative that encourages continual improvements of environment and workplace safety management. The Equator Principles which provides a basis for assessing social and environmental performance of project finance in emerging markets is an example of an industry lead initiatives. Both examples demonstrate the innovation and commitment of business and their willingness to embrace social and environmental practices that reflect and enhance their business activity.

CPA Australia research has identified legal and practical impediments that may limit the efforts of organisational decision makers including the absence of appropriate safe havens, or of an agreed framework for capturing, measuring and reporting social and environmental information.

c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

The current regulatory framework provides a strong and effective approach for Australian business and the wider public, and already has scope for directors to consider the interests of stakeholders other than shareholders. The framework must continue to evolve to ensure it remains relevant to the needs of the broader community and to this end CPA Australia believes there is scope for subtle reforms that increase clarity and certainty for all parties.

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. In fact, the law has developed to require directors to have regard to creditors' interests in certain circumstances. This is typically a leaning towards the extension of directors duties over time and in response to specific circumstances.

The directors' duty is to the ongoing health of the company and must include consideration of the needs of employees, consumers and other stakeholders. Any strategy directed purely at profit maximisation will be realistically tempered by a need to ensure the ongoing viability of the company. An awareness of changing community expectations can be accommodated within the current framework of directors duties.

The introduction of a formalised duty to external stakeholders will upset the cohesion within the evolving structure of the corporations law and create uncertainty. Directors' primary responsibility must be to the ongoing success of the business and a legitimate component of fulfilling this obligation is to consider all relevant stakeholder interests. Creating a separate duty to specific classes of stakeholder would require directors to consider those interests alongside the business rather than in the context of the viability of the business. This would also create a subjective assessment of the primacy of interests resulting in an increased risk aversion in commercial decisions.

The question must also be raised as to whether the Corporations Law is the most appropriate vehicle to achieve environmental, social and employment outcomes.

d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to laws other than the Corporations Act.

CPA Australia is of the view that some subtle reforms of the Corporations Act are sufficient to address current community concerns. Efforts to encourage or prohibit specific social or environmental practices should be addressed through relevant legislation including environmental and labour laws.

A clear distinction needs to be maintained between the largely benevolent and evolving concept of corporate social responsibility and manifest abuse of corporate limited liability. Responses in relation to the latter should be targeted to the mischief identified and not interfere with broader corporations law. There is a need for a more coherent basis for lifting the corporate veil, perhaps based on notions of joint tortfeasors, however such reform needs to be targeted and predictable.

Consideration could be given to extending the business judgement 'safe haven' relief to particular elements of director behaviour so as to protection from shareholder challenge, social responsibility based decisions made in good faith with a longer term view of the health of the corporation within the context of the communities of interest within which it operates.

The corporations law already imposes an obligation on companies to comply with any extraneous laws and this interaction has already compelled improved standards of conduct in environmental protection. It is more appropriate that positive obligations on companies to achieve certain social and environmental obligations are more appropriately dealt with in specific purpose legislation outside corporations law.

Current management practices in relation to corporate social responsibility are evolving and are likely to develop based on peer pressure and the need to respond to consumer interests without the need to drive change through legislative reform. There is little empirical evidence to suggest a case for reform through legislation.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and / or their directors.

CPA Australia fully supports the ongoing development of non-legislative measures that encourage the consideration of stakeholder interests. CPA Australia's project in conjunction with the University of Sydney aims to develop a framework for capturing, measuring and reporting social and environmental information that will enhance business ability to capture meaningful information for internal business decision making, and by extension external reporting. Practical steps such as these are necessary to bridge the gap between stakeholder expectations and business activity.

Such initiatives also drive improvements across the full reporting chain encouraging better reporting and by extension better understanding of business decision making and practices by information users including stakeholders.

Companies engagement with stakeholders is evolving and for this reason must be allowed to develop over time. CPA Australia is of the view that attempts to short-circuit such engagement through highly prescriptive regulation may encourage avoidance behaviour and undermine the good will and endeavours of all parties.

Moreover, the unique nature of individual businesses and their networks of evolving stakeholder interests does not lend itself to 'one-size-fits-all' mandated solutions.

A proactive approach towards voluntarism from business negates the risk of attracting excessive and inflexible obligations.

A full appreciation of the role of building capacity in relation to the management of social and environmental information, not merely as an adjunct to external reporting, is vital to the development of capacity to manage non-financial risk.

The need for regulation must be considered against the potential for alternative mechanism and drivers to deliver equivalent if not better outcomes for business and the wider community. There is much evidence to support the voluntary endeavours of business as enlightened corporations tend to achieve socially responsible outcomes without regulation or legislation. In addition bodies such as the Australian Stock Exchanges Corporate Governance Council has elevated corporate regard for the interests of stakeholders through its best practice guidelines thereby providing guidance endorsed by a wide range of participating stakeholders.

f) The appropriateness of reporting requirements associated with these issues.

Any debate around the appropriateness of current reporting requirements must be considered in the context of the impediments to reporting and by extension capacity to mandate reporting in law.

Environmental and social reporting by Australian companies lacks consistency and fails to match the rigour of financial reporting. Consequently, stakeholders are unable to compare 'apples with apples' in their evaluation of corporations and their practices. However simply mandating reporting requirements will not overcome these concerns.

CPA Australia in conjunction with the University of Sydney has already embarked on a 3 year project to develop a framework for capturing, measuring and reporting social and environmental information. The project will assist professionals and government regulators as well as many private and public sector organisations to better understand how the principles of sustainability reporting can be integrated and applied in a formal planning, risk management and decision making context.

Triple Bottom Line reporting has achieved limited penetration within Australia. There is limited business activity with CPA Australia's *Sustainability Reporting – Practices, Performance and Potential* confirming that only 24 of the top 500 ASX companies issued a stand alone sustainability report that covered more than one aspect of sustainability. CPA Australia's CICR 2005 research revealed that less than a third of public and shareholders were aware of the term 'triple bottom line reporting' well short of levels for 'corporate social responsibility' (public 85%, shareholders 89%) and 'sustainability'(Public 90%, shareholders 96%).

The evident gap and pressing need for development is in the realms of internal accumulation, measurement and analysis of environmental and social data. Through these means stakeholder engagement and participation will be nurtured.

Developments in accuracy, retrieval and verifiability of non-financial information will facilitate and strengthen the alternative path to improved social and environmental performance reporting; that of voluntary disclosure conducted within overarching principle based guidance.

Ultimately, an effective reporting regime will provide consumers with greater confidence in companies' disclosures in relation to environmental and social matters. Once this regime is in place, market forces are more likely to drive improvements in company performance. This approach will provide greater flexibility and ability to adapt to changing social expectations, than mandating specific company obligations in relation to environmental and social behaviour.

g) Whether regulatory, legislative or other approaches in other countries could be adopted or adapted for Australia.

The UK is the most comparable jurisdiction to Australia. Australia is as well placed as the UK to build on its existing regulatory regimes and structure of guidance to achieve a higher standard of disclosure corporations environmental and social performance. The UK has recently introduced legislation requiring directors to consider the interests of stakeholders beyond shareholders in their decision making. At present the impact of the legislation is untested and its is advisable that Australia adopt a wait and see approach to see if it

achieves the desired outcomes. The UK Accounting Standard Board has also recently issued a revised reporting standard (RS 1), however we are skeptical of its ability to achieve improvements without the accompanying sound reporting methodology.

CPA Australia will shortly release research looking at the regulatory regimes in place across 12 Asia Pacific jurisdiction. This research confirms that the development of social and environmental reporting across the region varies considerably. A number of initiatives are in place or in development, ranging from 'name and shame' to more structured reporting obligations. While CPA Australia has opportunity to learn from other jurisdictions, the research suggests that there is no single approach that stands out as a solution. Instead the research more readily supports a global response to the development of improved social and environmental reporting. Such an approach would substantially reduce the prospect of competing frameworks and increase comparability across regions in much the same way as the International Financial Reporting Standards are enabling a common global financial reporting language.

a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

Summary of conclusions:

- Recognition of a clear distinction between corporate social responsibility and the wider concept of corporate responsibility is essential to the development of appropriate responses to an emerging understanding of stakeholder interests separate from more highly targeted response to breaches of ethical standards of conduct.
- The strict notion of a profit maximization imperative is to a degree a misnomer with both the practicality of modern business, and the legal framework, affording to decision-makers a realistic capacity to make positive allowance for the interests of stakeholders.
- There is an emerging understanding of strategic behaviour recognize sustainability based practices as an increasing source of competitive advantage.

1.1 Some important definitions

Given the relatively broad nature of matters under consideration in both Terms of Reference (a) and (b), it is appropriate to commence with a definition of 'corporate social responsibility' as this concept is most synonymous with stakeholder interests, describing also what are often considered in association; Triple-Bottom-Line and Sustainability.

One of the more useful definitions of 'corporate social responsibility' is that provided by J. E. Parkinson:

> " - - - behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation".[1]

A number of features are noteworthy:

- it is far more than corporate philanthropy,
- it is narrower than 'corporate responsibility', the terminology used by the Committee, which embraces the further dimension of business ethics,[2]
- it moves beyond the narrow notion of a 'rule of corporate conduct' whereby companies strive to maximize profits within the law,
- it reflects a growing sensitivity to the impact of the corporation on third parties and external interests, and
- it does not necessarily infer a sustained divergence from a profit goal, but may present opportunities to identify and pursue competitive advantage.

According to Brundtland (World Commission on Environment and Development, 1987) sustainability is defined as: "Meeting the needs of the present generation without compromising the ability of future generations to meet their needs".

'Triple bottom line' (John Elkington 1998) refers the notions that organisations need to think, and in turn report, in terms of social and environmental dimensions alongside the traditional financial 'bottom line'. 'Quadruple bottom line' has more recently been coined to add a governance dimension.

1.2 Corporate decision-making powers and the public interest

The nature of corporate social responsibility necessarily enters into the domain of political theory and potentially subjective views of the legitimate exercise of powers and the sanctity of property,[3] such that "the resolution of nearly every issue of corporate social responsibility depends heavily on one's beliefs about how the political process operates and one's convictions about the ideal political process".[4] So that this 'debate'

[1] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 260-262.
[2] The aspect of business ethics is dealt with in our response to Terms of reference (d) in the context of the 'corporate veil'.
[3] In the corporate context, famously described by Dixon J: "They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage". *Peters' American Delicacy Co Ltd. v Heath* (1939) 61 CLR 457 at 504.
[4] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1.

may proceed under the Committee's deliberations and within the wider Australian community at a relatively apolitical level, it is suggested that a comparatively non-controversial assertion be accepted that large companies, in particular, are *social enterprises*;[5] a notion by which it is acknowledged that legitimate exercising of their extensive decision-making powers can and should be assessed from the perspective of a wider public interest and concern.

In considering the corporation as a *social enterprise*, Parkinson presents two dimensions which can assist in an assessment of the scope and propensity of corporate decision-makers to have a regard for stakeholders other than shareholders. These deal respectively with the idea of profit sacrifice and requirements of disclosure:

> " - - - no necessary finding that the root principle beneath the current rules of company law, that companies exist to make profits for the benefit of shareholders, is unsatisfactory. It is quite possible that the arrangement is the one that is most conducive to the public good. But the point is that making profits for shareholders must now be seen as a mechanism for promoting the public interest, and not as an end in itself".

and further;

> " - - - if we view the company as a public or social body, albeit under private control, then its directors and managers should be held to requirements of disclosure and standards of ethical conduct appropriate to those carrying out public functions".[6]

The first of these two points is considered below, whilst the second is examined in the context of Terms of Reference (f).

1.3 The paramountcy of profit maximization?

In a similar manner, Engel defines corporate social behaviour as behaviour that is distinguishable from a "corporate action taken because of management's belief that it will maximize profits in the long run even if it may damage them this week or this year".[7] Nonetheless, it is noted[8] that at least within the narrow perspective of the operation of corporate law, this trade-off between the short and long-term interests of members allows scope to acknowledge a capacity within the framework of directors' duties, a regard for wider stakeholder interests. As Parkinson observed:

> " - - - the legal model will in practice accommodate a measure of profit-sacrificing responsibility notwithstanding the duty of management to maximize profits, given that the strict enforcement of that duty is not feasible".[9]

The contemporary reality of a number of industrial sectors within which large companies operate is the degree of market concentration[10] that affords participants the opportunity to pass on part of the cost of social expenditure to customers.

However, within the pivotal sustainability dimension of corporate social responsibility, many of the decisions that are being made by managers are no longer one dimensional issues of either assessing the trade-off between short-term profit sacrifice and future returns or the capacity to shift the burden of incremental costs to customers. Rather, sustainability itself is increasingly identified as a source of business success beyond merely enhancing reputation. While this trend is not universally amongst business, a substantial base upon which future leadership and direction might be developed.

Research conducted by Goldsmith and Samson[11] shows that highly successful companies Australian companies identified as leaders in sustainable development business practices, whose source of competitive advantage contrasted between the innovative and quality/service/ reliability, demonstrated a limited number of key generic strategic orientations:

[5] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 23.
[6] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 23.
[7] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1 at 9.
[8] Please refer CPA Australia's submission in response to Terms of Reference (c).
[9] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 279.
[10] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 262.
[11] "Sustainable Development and Business Success: Reaching beyond the rhetoric to superior performance", Foundation for Sustainable Economic Development University of Melbourne, March 2005.

> "**Efficiency** refers to the range of sustainable development practices that make a direct or indirect contribution to the company's financial performance: and
> **Market edge** describes those practices that contribute to the company's market opportunities in terms of new markets, market share and profit opportunity. Research and development, innovation, and supply chain improvements are all examples"

The research conducted by Goldsmith and Samson further dispels the myth that sustainability practices and conducting a profitable commercial enterprise are mutually exclusive. They confirm that as the sustainability orientation becomes deeper aligned and congruent with other facets of strategy, improved adaptability, efficiency and market edge ensures. Nonetheless, capacity for economy and society-wide movement in this direction is embedded in wider issues of appropriate policy mix and a consideration of the role and capacity of business amongst 'other players' to affect positive social change. The following two brief examples illustrate that there is neither a practical nor strict legal impediment that precludes regard being given to a non-shareholder constituency of interest within an understanding of corporate social responsibility – the choice remains in part philosophical and attitudinal, and requires an understanding of appropriate models (outside of the law) against which business might operate.

A firm level initiative

Insurance Australia Group (IAG) 'Risk Radar for Smash Repairers' introduced in 2004 as a CD-Rom based product used by an extensive network of motor vehicle repair workshops, and associated suppliers, for the self-reinforcing continual improvement of environmental and workplace safety management. The industry is characterised by the uses and production of environmentally damaging materials and a high risk of workplace accidents. The processing implemented not only improved performance in these areas, but also has the capacity to reduce insurance premiums.

An industry level initiative

The establishment in 2002 of the Equator Principles[12] as a voluntary set of guidelines by which private financial institutions establish a better basis for managing evaluating/assessing the social and environmental performance in relation to complex project financing within emerging markets. Westpac Bank is noted as one of the founding global signatories to this corporate responsibility based initiative.

[12] http://www.equator-principles.com/principles.shtml

b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

Summary of conclusions:

- Against the backdrop of the accumulated impact of past economic activity, many of our assumptions about how business is conducted free from a regard for wider consequences are no longer tenable.
- Evolving corporate behaviour reflected through a widening regard for stakeholder interests can be seen as a response to these challenges.
- The greater challenges however are in the realms of establishing a focused and cohesive approach across a wider range of policy settings which allow for appropriate interaction of regulation and market mechanisms.

2.1 The changing local and global context of business

In addressing this complex question with at least some degree of brevity it is however appropriate to state a relatively wide context. This enables regard to be given to the role, limitations and stimulus for change to the practices of business and the function of organisational decision-making within an evolving and widening demand for both accountability and responsibility.

It is clear that there is growing threat to society's ability to continue to protect and enhance human quality of life in a manner which incorporates the need for economic prosperity and growth, social cohesion and equity, cultural diversity and environmental protection.

The convergence of a range of factors compels a shift toward a more overarching approach with *speed and scale.* The cumulative consequences of past practices are such that nationally, regionally and globally, societies are highly vulnerable in both economic and social dimensions. Thus what might have in the past been seen as plausible preventative measures may be largely ineffective and too late. To sustain future generations, many argue, requires current and future generations to radically rethink how we use markets, develop businesses, and trigger economic, environmental, cultural and social mechanisms.

Factors which could contribute to precipitating a crisis within the short-term (by say 2020), include:

- The economic development thrust in Asia which has adopted a 'grow first, cleanup later' attitude resulting in an array of social and ecological manifestations which could cumulatively impede further economic growth. The ensuing problems reach beyond national borders demanding responses at a regional and global level which are cognisant also of the globalisation of business.
- The growing likelihood of a sustained upward movement in oil prices as a precursor to declining production - industrial dependency and interdependency are such that incremental price increases caused by increased cost of recovery and capacity constrains will have a highly accelerated negative economic impact (termed Peak Oil).
- The current rethinking of the policy basis for understanding the externalities of economic behaviour with reference back to the 1960s social theory titled the "The Tragedy of the Commons" which describes the nature of individual economic choice whereby gains go to the individual and costs (externalities) are borne across the environment and the community (the commons). The aspect of "tragedy" implies passive inevitability warranting targeted intervention to offset the cumulative impact of rapacious behaviour through a balanced sharing of costs (in the broadest sense); examples – fisheries policy, water recycling, river system management.

2.2 The corporate behaviour response in the context of wider policy development

There is a need for a framework within which a more sustainable prosperity could emerge that optimises the interaction and correct policy selection of factors across regulation, markets, taxation, technological innovation, research, business and the community. Business functions are just one component in any such 'paradigm shift'. The choice of appropriate balance is compelled by a realistic understanding of both the capacity and inclination of business. Indeed there is deep cynicism even amongst relatively conservative commentators as to the capacity of business either individually or through its internationally-based

representative bodies to effect the type of change warranted without an active role being played by government and their agencies.[13]

Notwithstanding what has been described in our response to Terms of Reference (a) as an emerging propensity amongst a significant number of companies and their leaders towards the type of change envisaged, the paramount role remains for Government to both identify appropriate policy settings and to fulfil a leadership role in guiding balanced expectations as to the evolving scope of corporate responsibility.

A key feature of doing business successfully into the future will be the attainment of approval, cooperation and satisfaction, though not necessarily formal, of a widening body of stakeholders[14] - the dilemma of course being how to identify, and then, assess and fairly satisfy the demands of this non-shareholder constituency.

In our response to Terms of Reference (c) and (d), CPA Australia examines the scope, limitations and appropriateness of the corporate law as a means through which corporate responsibility is either affected or controlled. Our response to Terms of Reference (e) explores broad measures that have been suggested to build corporate responsiveness to stakeholders, whilst in responding to Terms of Reference (f), we specifically address the current development and future direction of non-financial reporting as a means of achieving or as an adjunct to corporate responsibility.

[13] see for example R. Gray and M. Milne, "Sustainability Reporting: Who's Kidding?" (July 2002) *New Zealand Chartered Accountants Journal*, in regarding as highly contestable what they saw as an assertion from the World Business Council for Sustainable Development (WBCSD) and the International Chamber of Commerce (ICC) that "the natural environment and social justice are safe in the hands of business".

[14] "Sustainable Development and Business Success: Reaching beyond the rhetoric to superior performance", Foundation for Sustainable Economic Development University of Melbourne, March 2005.

c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

Recommendations and summary of conclusions:

- The development of the law has shown a justifiable and cautionary approach to the recognition of an actionable duty owed to creditors, any introduction of further stakeholders into the formal 'equation' of director duties would be highly inconsistent with Australian legal development.
- There is a need to strike an appropriate balance in business regulation that does not deter business investment and participation.
- An awareness of an imperative for business adaptability which reflects a sensitivity to changing community expectations is capable of accommodation within the current framework of directors duties.
- The introduction of a formalised duty to external stakeholders potentially upsets the essential cohesion within the evolving structure of the corporations law.
- A regard for ensuring the future viability of the corporation coupled with an understanding of a duty owed to future members presents a substantial but controlled latitude for a responsiveness to changing community expectations of corporate responsibility within management decision making powers.

Within the context of Terms of Reference (c), it is appropriate to commence with a description of to whom it is that directors owe their duties and the scope that may exist to consider the interests of stakeholders other than shareholders. With this as background, it is appropriate to then consider particular categories of director duty within which a regard for wider stakeholder interests is currently capable of accommodation.

3.1 In whose benefit are directors' duties exercised

J.D. Heydon in "Directors' Duties and the Company's Interests"[15] offers a series of formulations of duty under the preface statement: "Directors must act bona fide for the benefit of the company as a whole."[16] Commenting on the related notion of "best interests of the company" Heydon makes the following remark:

> " - - - (it) does not mean the sectional interests of some, or a majority, or even all the present members, but of present and future members; a long-term view should be balanced against the short-term interest of present members. The 'future members' of a company are another reflection of the interests of the company as a distinct corporate entity, separate from the short-term interests of present shareholders. Apart from the interests of shareholders, advancing the interests of the company may require attention to the interests of creditors."[17]

A number of elements of this quotation are noteworthy; the interests of creditors, the interests of the company as a distinct corporate entity and the balancing of short and long term interests and are dealt with in turn.

3.1.1 A duty owed to creditors

Both judicially and in the legal academic literature, consideration has been given to compelling directors to have a regard to wider stakeholders interests is in regard to unsecured creditors. The current understanding provides a foundation for considering a wider constituency base and identifying the means through which such interests might be reflected without adverse impact on the premises upon which incorporation is based.

A reorientation of directors' duties in times of insolvency or severe financial stress away from the interests of shareholders towards those of creditors is often used as the starting point for examining the economic validity of creditor protection inherent in the insolvent trading rules. The common law position, founded in the seminal case of *Salomon v Salomon & Co Ltd*,[18] which establishes the principle that a company's officers are not personally liable for the debts of the company, has generated a sequence of common law and equitable responses to protect shareholders. These are drawn either by "superimposing a number of mandatory

[15] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 p 120.
[16] *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J.
[17] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 p 123.
[18] [1897] AC 22.

elements of trust law" or by the courts of equity developing the "rubric of fiduciary duties not to individual shareholders themselves, but to the company as a separate legal entity."[19]

Within this scheme of general law development, a duty owed to creditors in situations of corporate insolvency has amounted only to a 'take account of' level. As articulated by Street CJ in *Kinsela v Russell Kinsela Pty Ltd*:

> " - - - the interests of creditors intrude - - - through the mechanism of liquidation, to displace the powers of shareholders and directors to deal with the company assets."[20]

This indicates that once a winding up has commenced, the interests of creditors are paramount. However, in the 'twilight zone' leading up to insolvency the position of an identifiable duty to creditors has been uncertain. In what has been described as a 'quiet revolution' a line of authority has been regarded as suggesting a wider directors' duty to creditors intervening at a relatively lower threshold. Typical of these cases is *Grove v Flavel* in which the following remark is made:

> " - - - 'duty' of a director to have regard to the interests of creditors when the company is known to be insolvent there can be no reason in principle why knowledge of a real risk of insolvency should not attract the same duty."[21]

However more recent authority from the High Court concludes that:

> "In so far as remarks in *Grove v Flavel* suggest that the directors owe an independent duty to, and enforceable by, the creditors by reason of their position as directors, they are contrary to principle - - - and do not correctly state the law."[22]

Notwithstanding this unambiguous statement[23] from the High Court, the earlier position taken by Mason J would still hold true that where a director might be regarded as being required to give consideration to the interests of creditors, this will be manifest in a duty owed to the corporation:

> " - - - it should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them."[24]

The fact that *Spies v The Queen* may have put an end to the 'quiet revolution' does not of itself preclude directors taking into account the interests of those, aside from shareholders, who interact with the company so long as those interests are embraced in the execution of a duty owed to the company. Thus as Heydon concludes:

> " - - - the law permits many interests and purposes to be advantaged by company directors, as long as there is a purpose of gaining in that way a benefit to the company."[25]

CPA Australia submits that this approach is readily adaptable to accommodate stakeholder interests. Moreover, it should be noted that any creation of a creditor or other stakeholder actionable interest is likely to engender undue commercial risk aversion.

3.1.2 The interests of the company as a distinct corporate entity

The above discussion notes that interests wider than shareholders can be contemplated within the interests of the company, the broadness of these interests can be considered from the perspective of the corporate boundary. A comparatively radical "communitarian" perspective would, in contrast, deny the presumed

[19] Mannolini J, "Creditors' Interests in the Corporate Contract: A Case for the Reform of our Insolvent Trading Provisions" (1996) 6 *Australian Journal of Corporate Law* 16.
[20] (1986) 4 NSWLR 722 at 730.
[21] (1986) 11 ACLR 161 at 170 per Jacobs J.
[22] *Spies v The Queen* (2000) 201 CLR 603 at 636-637.
[23] Decisions subsequent to *Spies* have generated debate at least amongst academics, see A. Hargovan, "Geneva Finance and the "duty" of directors to creditors: Imperfect obligation and critique" (2004) 12 *Insolv LJ* 134.
[24] *Walker v Wimborne* (1976) 137 CLR 1.
[25] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 p 135.

primacy of shareholder interests and further disregard the notion of corporate legal personality central to development of company law in common law jurisdictions:

> "Grounded in sociology and notions of the corporation as community, communitarianism focuses on vulnerability of non-shareholder constituencies and challenges the contractual theory of the corporation."[26]

The extent and manner by which various theories of the corporation might inform the development of corporate law is discussed in more detail elsewhere in this submission. However, an evolving understanding of stakeholder interests arising out of the corporation's interaction with the wider community can be accommodated within the existing framework of directors' duties. The following Canadian authority foreshadows this emerging flexibility:

> "The classic theory is that the directors' duty is to the company. The company's shareholders are the company - - - and therefore no interests outside those of the shareholders can legitimately be considered by the directors."
> "In defining the fiduciary duties of directors, the law ought to take into account the fact that the corporation provides the legal framework for the development of resources and the generation of wealth - - - ."
> "A classic theory that once was unchallenged must yield to the facts of modern life. - - - I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of the company's shareholders in order to confer benefit on its employees: Parke v Daily News Ltd., [1962] Ch. 927. But if they observe a decent respect for the interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company."[27]

The notion of a qualified regard for a public interest embodied in directors' duties can likewise be found in Australian judicial comment:

> "It is a fundamental principle of company law that the directors owe a fiduciary duty to the company. The rule is one protective of the company and its shareholders. But it is also protective of the public interest which is served by integrity in the conduct of company officers."[28]

The remarks above reflect an appropriately controlled and measured openness in the law to accommodate evolving community expectations without adversely affecting the legal instruments and structures through which commerce is transacted. The stimulus for the insight into an evolving interaction between commercial imperative and a more enlightened approach to the role of business in the wider community, can be deduced from the comments of key business leaders reported in the public domain:

> "Business often argue that if they were to fully serve the interests of their community, they would neglect their shareholders and not realise their company's economic potential. Arguing the contrary, Mr Samuel claimed that success of a corporation was largely dependent on its sensitivity and responsiveness in the community. Mr Samuel said the most important trait of a business was its ability to adapt, readapt and continuously readapt to any changes."[29]

These remarks draw a subtle but important distinction between an evolving sensitivity to community expectations as to the behaviour of business, operating almost as a form of informal license, and 'corporate responsibility' which may denote aspects of compulsion on top an existing complex array of environmental and social obligations to which business must already comply. CPA Australia believes it is important to strike an appropriate balance in business regulation that does not deter business investment and participation.[30]

These aspects of appropriate form and mix of regulation are considered further in relation to Terms of Reference (e) and (f). A more holistic approach to setting policy to deal with environmental externalities of the conduct of commercial activities is addressed in our response to Terms of Reference (b).

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[26] Hill J, "Public Beginnings, Private Ends – Should Corporate Law Privilege the Interests of shareholders?" (1998) 9 *Australian Journal of Corporate Law* 21 at 24.
[27] Teck Corporation Ltd v Millar (1973) 33 DLR (3d) 288 at 313-314 per Berger J.
[28] Darvall V North Sydney Brick & Tile Co Ltd & Ors (1989) 15 ACLR 230 at 231 per Kirby P.
[29] Report on Plenary Keynote Address "Competition with Compassion" given by Graeme Samuel AO Chairman ACCC on 7 May at "Future Summit 2005", Melbourne, the Australian Davos Connection.
[30] Without necessarily endorsing its content, CPA Australia suggests a valuable source of analysis of the interaction between regulation and business competitiveness is the 2005 Business Council of Australia "Business Regulation Action Plan for Future Prosperity".

3.1.3 Duties and in whose interest are powers to be exercised

Both the above passages from *Teck* and *Darvall* allude to the fiduciary duty being owed to the company as distinct from being owed directly to shareholders. The nature of fiduciary relationships has been analysed by the High Court concluding that:

> "The principle - - - is that the fiduciary cannot be permitted to retain a profit or benefit which he has obtained by reason of his breach of fiduciary duty. - - - A fiduciary is liable to account for a profit or benefit if it was obtained (1) in circumstances where there was a conflict, or possible conflict of interest and duty or (2) by reason of the fiduciary position or by reason of the fiduciary taking advantage of opportunity or knowledge which he derived in consequence of his occupation of the fiduciary position."

> "The categories of fiduciary relationships are infinitely varied and the duties of the fiduciary vary with the circumstances which generate the relationship. Fiduciary relationships range from the trustee to the errand boy - - - (and) the nature of the curial intervention will vary from case to case."[31]

Whilst a line of case development[32] has arisen recognising either a reliance on or detriment basis of a directorial fiduciary duty owed to shareholders individually, "authorities have long accepted that 'special facts', such as the director's possession of information - - - may take a particular case outside of the general rule that directors owe no fiduciary duty to shareholders".[33] Moreover, in the realm of statutory coverage of directors' duties characterised by application of fiduciary principles,[34] the type of matters dealt with are typically relationship-based dealing with matters such as the requirements to act in good faith and avoid misuse of powers. As such any development in the law of directors' duties towards enforceable stakeholder interest potentially creates uncertainty in the conduct of a corporation's affairs.[35]

This dichotomy between directors and the company on the one hand, and the company and its members (shareholders) on the other, is further illustrated in what is termed the 'statutory contract':

SECTION 140 **EFFECT OF CONSTITUTION AND REPLACEABLE RULES**

140(1) **[Contract]**

A company's constitution (if any) and any replaceable rules that apply to the company have effect as a contract:

(a) between the company and each member; and
(b) between the company and each director and company secretary; and
(c) between a member and each other member;

under which each person agrees to observe and perform the constitution and rules so far as they apply to that person.

Whilst the relationships specified herein focus on aspects of corporate governance and the conduct of internal affairs, the introduction of a formalised duty to external stakeholders upsets the essential cohesion that has to date largely been achieved in the evolving structure of the corporations law.

3.2 The managerial function and the constraints on the exercise of these powers

Both statute and general law reinforce the principle that a corporation is a separate legal entity and that directors are responsible for the management of the company. The corporate entity is freely capable of contracting as a principle in its own right, rather than as trustee or agent for the shareholders. In *Salomon v Salomon*[36] the doctrine is given full weight in the words of Lord Halsbury – "once the company is legally incorporated it must be treated like any other independent person with its own rights and liabilities appropriate to itself".

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[31] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 per Mason J.
[32] *Coleman v Myers* [1977] 2 NZLR 225 and *Brunninghausen v Glavanics* (1999) 32 ACSR 294
[33] Goddard R, "Percival v Wright: The End of a "Remarkable Career"?" (2000) 116 *The Law Quarterly Review* 197.
[34] s 181 Good faith, s 182 Use of position and s 183 Use of information.
[35] These arguments are elaborated upon in CPA Australia's submission (September 2005) in response to CAMAC's Discussion Paper "Corporate Duties Below Board Level" (May 2005).
[36] [1897] AC 22.

This separate legal personality of a corporation is further overlayed by judicial recognition given to corporate management whereby, it is only the directors who are able to exercise powers of management, except in the matters specifically allotted to the company in general meeting. Greer LJ in *John Shaw & Sons (Salford) Ltd v Shaw*[37] after reiterating the *Salomon* principle that "a company is an entity distinct alike from its shareholders and directors" goes on to say "powers of management are vested in the directors, they alone can exercise those powers."

This division of powers is now embodied in legislation:

SECTION 198A **POWERS OF DIRECTORS (*REPLACEABLE RULE — SEE SECTION 135*)**

198A(1) **[Management of business]**

The business of a company is to be managed by or under the direction of the directors.

Note: See section 198E for special rules about the powers of directors who are the single director/shareholder of proprietary companies.

198A(2) **[Exercise of powers]**

The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.

What then are the constraints that have evolved in relation to the exercise of powers of management? While s 180 signifies the primary statutory source, development of associated case law is insightful in describing a negligence based duty of care. Prominent amongst the authorities is *Daniels v Anderson*[38] in which the joint judgement of Clarke and Sheller JJA is significant in describing the broad sources of law (tort of negligence) and precedent developments (insolvent trading) which have shaped the law's expectation as to scope and parties affected under common law obligations. Their Honours make the following remarks:

> "The source of the duty of care at common law rests in the relationship of proximity. - - - We see no reason why the relationship of a director to a company should not, in accordance with the law as it has developed since *Hedley Byrne & Co Ltd v Heller & Partners* [1964] AC 465, not satisfy the proximity test."[39]

This perspective on the constraints placed on directors in the exercise of powers of management can be examined further within the scope of Terms of Reference (c):

- firstly, in relation to a presumed objective of profit and shareholder wealth maximisation, and
- secondly, in terms of how this corporate law based duty might promote or compel, and even protect from challenge, compliance with separate laws falling under a broad banner of corporate responsibility; be they environmental or social.

3.2.1 Corporate profit and shareholder wealth maximisation

There is a prevalence of view fostered by neoclassic economists,[40] that the justification for the businesses' existence is a "single-minded pursuit of profit maximization"[41] against which neither regard nor obligation exists to consider the social and environmental consequences of business. However Lord Wedderburn argues a lessening of the strict notion of management power being exercised for the sole benefit of the owners, and consistent with an understanding of the evolving implications of the extensive legal privilege granted through limited liability,[42] management powers might be held "in trust for the entire community".[43]

[37] (1935) 2 KB 113 at 134.
[38] (1995) 16 ACSR 607.
[39] (1995) 16 ACSR 607 at 656.
[40] Milton Freidman
[41] Lord Wedderburn of Charlton, "The Social Responsibility of Companies" (1985) 15 *Melbourne University Law Review* 4.
[42] We discuss limited liability and the corporate veil in more depth in our response to Terms of Reference (d).
[43] Lord Wedderburn of Charlton, "The Social Responsibility of Companies" (1985) 15 *Melbourne University Law Review* 4 at p 6.

Without in anyway approaching an endorsement of the communitarian perspective described above, his Lordship expressed a degree of comfort with the idea that:

> " - - - modern management frequently declares itself a trustee for employees, consumers and stockholders and may even affirm a social responsibility to a wide variety of societal segments which have a stake in the continued health of the corporation".[44]

Therefore managers' pursuit of short term profit maximization is realistically tempered by the need to ensure the future viability of the corporation. This, coupled with an understanding of a duty owed to future members, presents a substantial but controlled latitude for a responsiveness to changing community expectations of corporate responsibility within management decision making powers.

3.2.2 Corporation law as an avenue for achieving environmental and social objectives

A further question raised is whether corporations law is the appropriate vehicle through which desirable environmental and social outcomes should be compelled or promoted. The neoclassic perspectives have contributed in part to the emergence, particularly in the United States, of *law and economics* scholarship that views the development of law from the perspective of a limited role of statute against which judicial decision would adopt an elevated role of "promot(ing) free markets and efficient use of resources".[45]

Whilst it is not within the scope of this submission to describe the mixed fortunes of *law and economics* in shaping both statutory and judicial development, it is reasonable to conclude that it has not achieved its proponents' objective of a 'wealth maximization' concept engendering certainty into the law.[46] This characteristic of certainty in the law can be applied to identifying the dichotomy between the proper functions of the corporations law and the attributes of those parts of the wider public law which regulate the conduct of all persons, natural and legal, in relation to environmental and wider social needs. Writing in 1987, Professor Sealy made the still highly relevant observations:

> " - - - company law (at least as it stands, but probably in any form it could potentially take) must acknowledge that it has no mechanism to ensure the fulfilment of obligations of social responsibility. At most, it may impose disclosure obligations - - - .The interests of consumers, the environment, welfare and the cause of equal opportunity, good race relations and so on can only be furthered by positive legislation extraneous to company law."

and further;

> "But there are many snags. It is not the director's primary role to take care but to take risks. A duty of care and the liberty to take risk are incompatible bedfellows".[47]

The duty of care as it exists in current corporations law[48] is directed exclusively at a relationship between the directors and the company:

> "The closeness of the relationship between the company and its directors and between the act or omission and the damage caused satisfied the requirements of the test of proximity discussed by the High Court in *Sutherland Shire Council v Heyman* (1985) 157 CLR 424. There were no policy considerations disqualifying the relationship from giving rise to a duty of care; *Gala v Preston* (1991) 172 CLR 243."[49]

A formalised embodiment of social responsibility into directors' duty of care creates a risk of that it will be difficult to determine the obligations of directors and potentially negate the premise of limited liability. The aspect of care in relation to social responsibility based matters is best pursued through directors' ensuring compliance with laws outside the purview of corporations law with well defined environmental and social objectives. Any failure in these regards could potentially render the company subject to a harm that may, in turn, result in the responsible director being sanctioned within the better understood duty of care.

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[44] Lord Wedderburn of Charlton, "The Social Responsibility of Companies" (1985) 15 *Melbourne University Law Review* 4 at p 6.
[45] N Andrews, "Bad Company? The Corporate Form in an Uncertain Law" (1998) 9 *Australian Journal of Corporate Law* 39 at 48.
[46] N Andrews, "Bad Company? The Corporate Form in an Uncertain Law" (1998) 9 *Australian Journal of Corporate Law* 39 at 49.
[47] "Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural" (1987) 13 *Monash University Law Review* 164 at p 176.
[48] s 180 Care and diligence
[49] (1995) 16 ACSR 607 at 654 per Clarke and Sheller JJA.

This approach is very much at the centre of a rationale recently described in the literature:

> " - - - the directors of a company which has breached environmental statutes blatantly or continually may be acting in disregard of their duty of care under s 180".

and further;

> "The point that is being made in this article is that in addition to any such obligations in the environmental statute, the Corporations Act (together with the common law) also contains remedies and penalties when directors fail in their duty to ensure corporate compliance with an environmental law".[50]

The matter at issue[51] in the case cited[52] by the authors is remote from environmental law. Pending a more direct judicial testing of the issue, CPA Australia suggests in its response to Terms of Reference (d), that a limited number of related incremental developments in the direction of corporate law might result in a clearer recognition of a link between a breach of environmental law and a breach of a duty owed to the company, or conversely, ensuring directors' actions aimed at environmental protection and wider stakeholder interests within the evolving understanding of the company's interests are protected.

[50] Bielefeld, Higginson, Jackson and Ricketts, "Directors duties to the company and minority shareholder environmental activism" (2004) 23 *Company & Securities Law Journal* 28 at p 36.
[51] An absence of controls to safeguard against unlawful investments.
[52] *ASIC v Adler* (2002) 41 ACSR 72.

d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to laws other than the Corporations Act.

Recommendations and summary of conclusions:

- CPA Australia suggests consideration be given to extending the business judgment 'safe haven' relief to particular elements of the duty of good faith to give greater certainty to social responsibility based decisions.
- This proposal may protect directors from undue or disruptive challenge to decisions made within a widened ambit of "interests of the company as a whole".
- Environmental and socially oriented management decisions that can be reconciled with a wider perspective of the long-term interests of the corporation would be protected from unreasonable member challenge.
- Amendment to the Corporations Act to give standing to persons other than members in the areas of oppressive conduct, derivative actions and injunctive relief, is both unnecessary and undesirable.
- A clear dichotomy needs to be maintained between the objectives and functions of the corporations law and other laws which mandate and promote environmental and social conduct across all participants in society.
- It is through the latter of these two broad 'branches' of the law that desirable environmental and social outcomes are most effectively promoted.
- A clear distinction needs to be maintained between the largely benevolent and evolving concept of corporate social responsibility and manifest abuse of corporate limited liability. Responses in relation to the latter should be highly targeted to the mischief identified and not interfere with the broader evolving nature of the corporations law.
- Whilst there is clearly warranted development of a more coherent basis for lifting the corporate veil, perhaps based on notions of joint tortfeasors, such reform needs to be targeted and predictable.

4.1 The Business Judgement Rule

In CPA Australia's recent submission to the Corporations and Markets Advisory Committee (CAMAC) review of Corporate Duties Below Board Level, the development of the statutory business judgement rule was addressed in the following terms:

> CLERP Proposal Paper No 3 (5.2.2) referred to the need to seek a balance between responsible risk taking, accountability to shareholders and the reluctance of courts to review bona fide business decisions. The latter point is illustrated in judicial comments such as:
>
> > " - - - they (their Lordships) accept that it would be wrong for the court to substitute its opinion for that of management - - - . There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at."[53]
>
> The objective in codifying this general law principle has been to protect legitimate business risk type decisions from judicial scrutiny and thus challenge by shareholders. The statutory form sits appropriately in direct relationship with duties of care and diligence (by inference also skill) as these are the attributes that most directly relate to the management of the company. However when applied to ss 182 and 183 (and their criminal law counterparts in s 184) aspects of fiduciary relationship to which the courts take a far more critical approach, are being dealt with.
>
> It is CPA Australia's view, that to allow some form of business decision based relief in these latter areas could run counter to long established notions that preclude taking corporate advantage. Nonetheless, it is suggested that there may be some scope to extend this form of 'safe haven' relief to matters potentially dealt with under s 181(1)(a)[54], particularly given some similarity in wording.[55]

Applied to the specific matters contemplated in the Committee's Terms of Reference, development of this type may provide a valuable adjunct to the notion of "interests of the company as a whole" in which there is

[53] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 834 per Lord Wilberforce.
[54] Though not s 181(1)(b) as courts have typically dealt strictly with aspects of 'proper purpose'.
[55] Section 180(2)(d) operating as one of the qualifiers on the business judgement protection requires the director or officer to "rationally believe that the judgement is in the best interests of the corporation".

scope for a targeted regard of wider stakeholder interests consistent with the objective of preserving the ongoing viability of the company for future members.

4.2 Flexibility and adaptability of members' remedies

There is merit in further incrementally based development of the oppressive conduct remedy (s 232 of Part 2F.1). Subsection (d) provides a basis upon the application of a member[56] for the court to make orders[57] where the conduct or omission on behalf of the company is "contrary to the interests of the members as a whole". The development proposed would protect the directors from undue or disruptive challenge to decisions made within a widened ambit of "interests of the company as a whole". Such development would leave not alter the application of the further 'limb' of s 232; that dealing with acts and omissions which are 'oppressive', 'prejudicial' or 'discriminatory' against members.[58]

Support for development in the proposed direction can be found in the comments of the authors of Ford's:

> "In balancing the interests the court comes close to determining the merits of a board decision. That is something courts have traditionally refrained from doing when the decision is a commercial one. Courts have expressed support for a similar approach in applying the oppression section".[59]

On this basis, it is possible to conclude that environmental and socially oriented management decisions that are reconcilable with a wider perspective of the long term interests of the corporation, and would be protected from unreasonable member challenge.

For completeness it is appropriate to consider the converse perspective - that of the capacity for approval of such initiatives, were the law as it relates to the ambit of business judgement not to evolve as envisaged in the above discussion. Again, the law currently provides scope for such accommodation without the need for legislative intervention. Such decisions on the part of directors would prima facie be contraventions of s 180[60] or the 'best interests of the corporation' limb of s 181[61] and may, it is suggested, be open to member ratification. Such powers reserved to the members in general meeting are relatively wide:

> "The consequence of these limitations on the scope of ratification should not be overstated. Provided there has been full and frank disclosure of the nature of any particular breach and of the fact that absolution is being sought for that breach, a wide scope remains for valid ratification".[62]

This discussion deals exclusively with directors actions and their interaction with members. As Terms of Reference (c) deals with an expanded notion of stakeholder interests, it is appropriate to consider extending the various facets of remedies that have developed to protect members to a wider constituency. As with a duty owed to creditors, recognition of a direct actionable duty under the corporations law owed to other stakeholders is neither practical or desirable. This should preclude any contemplated amendment to Part 2F.1 and Part 2F.1A[63] to accommodate these groups.

One further avenue which might suggest itself open to development towards providing non-member stakeholders with a capacity to compel a corporation to what they may perceive as responsible behaviour, is in the realm of s 1324 Injunctions.[64] Clearly the conduct referred to in (a) through to (f) of subsection (1) are contraventions of the Act itself, though as described above there is some suggestion by which a nexus might be drawn between a failure to comply with an environmental law and a breach of a duty of care and diligence. Aside from the question of the sustainability of such argument, the more critical matter is that of to whom standing might be granted to seek an injunction.

The conclusion drawn by Einfeld J in *Airpeak v Jetstream*[65] that the interests of a creditor may be a sufficient interest to establish standing for the grant of an injunction[66] under s 1324 cannot, in CPA Australia's view, be

[56] section 234
[57] section 233
[58] section 232(e)
[59] Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed., Butterworths, 2003) [11.450].
[60] Care and diligence
[61] Good faith
[62] *Miller v Miller* (1995) 16 ACSR 73 at 89 per Santow J, the 'limitation' on ratification referred to by his Honour relate to fraud on the minority, misappropriation of company resources, insolvent trading transactions or decisions to defeat a member's personal right.
[63] Proceedings on behalf of a company by members and others
[64] Part 9.5 - Powers of Courts
[65] (1997) 23 ACSR 715 at 721.

taken as a foundation for a wider external interference in corporate conduct. Moreover, such development falls into the category where for certainty and predictability in the law it is necessary to identify the most appropriate avenue to achieve desired outcomes and desirable behaviour – restraint of behaviour that contravenes environmental laws or offends expectations as to conduct within the wider community is best dealt with directly through specific legislation in those areas.

4.3 Limited liability and the corporate veil – the nature of abuse and how it might be handled into the future

A clear distinction should be drawn between the general trend of an evolving understanding of corporate responsibility and instances of either abuse or failure of the corporate form which results in a group affected by corporate conduct being substantially disadvantaged. Development in relation to the corporate responsibility can be accommodated from the perspective of incremental development of corporate law and an understanding of stakeholder engagement. However, corporate abuse is a dramatically different dimension and should unduly shape the broad development of corporate responsibility and the law of directors' duties. It is essential to identify the specific character of any ills or abuse apparent within corporate behaviour, and then assess the adequacy of the law to prevent such action in the future rather than amending the Corporations Act creating a further overlay of complexity or duplication.

4.3.1 Theories of the corporation

Various theories have emerged to either explain or provide a context of corporate regulation and the behaviour of participants therein. These serve as a useful basis to consider the contrasting demands or stresses being placed on the assumed role and functioning of the corporation in the economy and wider community.

In the first instance, considering the aspect of corporate responsibility, it is appropriate to review the emergence of 'communitarianism' described in our response to Terms of Reference (c) which envisages dismantling the shareholder/company/manager relationship to give effect to redistributive outcomes which downplay both the profit motive and the essential proprietary basis of shareholder participation. As is acknowledged in the academic literature:

> "The difficulty with this approach is that it involves a more sustained attack on conventional capitalism than it is politically expedient to make".[67]

Whilst development of this view is likely to be untenable in a free-market economy such as Australia's which has espoused the virtues of share ownership and developed a structure of retirement savings underpinned by institutional investment, any such debate should not be confined to a primary emphasis on corporate law, as in the Committee's Terms of Reference.

Without attempting to describe and reconcile the merits of the contrasting contractarian[68] and state-conferred privilege[69] theories of the corporation and limited liability, the latter at least provides an applied framework for dealing with the complexities that may have motivated the Committee's Inquiry. Possibly allied to concession theory is the 'doctrine of separate legal entity' which views "the company as a legal being in its own right (so that) an act committed in the name of the company is regarded as its own act"[70] rather than regarding the company as a convenient abstraction.

Arising as it does out of an instrumental function provided for in the Corporations Act[71] "parliament has made limited liability available to those who incorporated as a company limited by shares"[72] and "that (this) policy

[66] The matters dealt with related to alleged breaches of s 232(4) & (6); the forerunners of current ss 180(1) and 182.
[67] S Wheeler, "Inclusive Communities and Dialogical Stakeholders: a Methodology for an Authentic Corporate Citizenship" (1998) 9 *Australian Journal of Corporate Law* 1 at 11.
[68] Also referred to as 'nexus of contracts'.
[69] Also referred to as 'concession theory'.
[70] H Anderson, "The theory of the corporation and its relevance to directors' tortious liability to creditors" (2004) 16 *Australian Journal of Corporate Law* 73 at 77.
[71] Chapter 2A – Registering a company.
[72] section 112 Types of companies

decision can be vindicated on economic grounds".[73] The aspect of state concession does not however grant an unfettered freedom to incorporators and their companies:

> "But the state clearly reserves the right to rewrite the ground rules and to constrain the freedom of corporate actors. Even as corporate law lets the participants proceed, it in effect cautions them that they may act at will only if on good behaviour. Corporate law facilitates private behaviour, but with a reservoir of suspicion and a threat of constraint".[74]

4.3.2 Constraints on directors' and corporate behaviour: internal affairs and external interests

The notion of a 'threat of constraint' provides a useful perspective on determining where within the broad scheme of the law particular relationships or emerging ills and abuse are best addressed. Moreover, this perspective emphasises the imperative of cohesion and consistency both within the corporations law and in its interaction with other branches of the law.

A further perspective which seeks to explain the nature of corporate law on the basis of the relationship between the key participants, is that of *managerial theory* which suggests formal corporate law as the only meaningful constraint on managerial behaviour:

> " - - - managers, freed from legal constraints, can abuse shareholders interests without cost. Corporation law, according to this view, plays a pre-eminent role in maintaining balance in the large corporation characterised by separation of ownership and control".[75]

A substantial part of the statute which overlays the grant of limited liability with defined directors' duties and a structure of member remedies can thus be rationalised in this context. Nonetheless, objectives of corporate social responsibility may well evolve within this framework without attracting the need for any substantial amendment to the Corporations Act.

Additionally, this perspective reinforces an understanding of corporate law as primarily concerned with government regulation of the internal affairs of the corporations it allowed to be created. Returning to the comments of Professor Sealy, external interests such as the environment and wider social aspirations are best served through "positive legislation extraneous to company law" to which the corporation is subject. If these 'extraneous law' are deficient in meeting evolving societal expectations, the primary avenue for redress should be through direct amendment or harmonisation of these laws, rather than adapting to an inconsistent or foreign purpose corporations laws which have evolved to meet fundamentally different needs.

The capacity for laws extraneous to the Corporations Act to overcome perceived impediments resulting from corporate personality demonstrates a range of means for identifying offences, a structure of orders or penalties and appropriate defences that are better targeted and understandable within the context of their own defined objective. Zada Lipman, from Macquarie University, in discussing the 'directing mind and will'[76] of the company in the context of corporate criminal liability under the *NSW Protection of the Environment Act 1997*, makes the following observations:

> "The Act overcomes these problems by extending the range of persons whose intention can be attributed to the corporation to persons lower down the corporate ladder, such as employees or agents. Thus, evidence of the *intention* of an officer, employee or agent to commit an offence is regarded as evidence of the corporations *intention* (s 169(4))".[77]

Additionally, the aspect of director or other persons derivative liability for corporate fault under Commonwealth, State and Territory environmental protection, occupational health and safety, hazardous

[73] M Whincop, "Overcoming Corporate Law: Instrumentalism, pragmatism and the Separate Legal Entity Concept" (1997) 15 *Company and Security Law Journal* 411 at 417.

[74] W Bratton, "The 'Nexus of Contracts' Corporation: A Critical Appraisal" (1988-1989) 74 *Cornell Law Review* 407 at 445.

[75] H Butler, "The Contractual Theory of the Corporation" (1988-1989) 11 *Geo. Mason University Law Review* 99 at 102.

[76] The authoritative statement is that of Viscount Haldane in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 where it is stated at 713: " - - - the corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its activity and directing will must consequently be sought in the person who for some purposes will be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation."

[77] "Corporate and corporate officer liability for pollution" (2005) 2(7) *Contract management in practice* 93 at 94.

goods and fair trading statutes has recently been the subject of a CAMAC Discussion Paper.[78] Given that this review seeks to find a fair and more harmonised or predictable basis for individuals incurring personal penalties in consequence of corporate fault, any suggested change to the directors' duties under the Corporations Act will need to be considered in the context of that Committee's findings and any recommendations.

These two broad categories of legal relationship between the director and company/member and between the company and various public laws which are invoked to compel standards of conduct in environmental protection and similar matters, seem highly capable of evolving in relation to changing demands.

4.3.3 'Corporate veil' abuse – practical and ethical consequences

The interaction of separate corporate legal personality and occurrence of mass tort is more problematic in shaping the debate about the social and ethical responsibility of companies and their directors, particularly with the added complexity of substantial long-tail liability – that is, liability which arises many years after the events or transactions which gave rise to them. These events call into question the adequacy and appropriateness of insolvency law to deal with such eventualities. More specifically related to the matters being considered by the Committee, is the use or presence of limited liability to frustrate satisfaction of such legitimate claims.

What is being dealt with here are not so much subjective aspects social responsibilities, but legal obligations which are either manifest or formative overlayed by clear issues of ethical standards and compulsion. Whilst the Committee's terms of reference do not refer to James Hardies Industries, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, does so in his announcement of a referral to CAMAC[79] seeking their consideration and advice in relation to directors' duties and corporate social responsibility.

To place the issues in context, the following extracts from a speech by Rob Hulls, the Victorian Attorney-General, are presented:

> " - - - some people casually slip behind the anonymity of the corporate veil once they reach the office and leave their moral obligations at home".
> " - - - I am forced to come back to James Hardie as a case in point because the James Hardie scandal has thrust the corporate social responsibility of directors into the spotlight. James Hardie made money from products that contained harmful, lethal substances causing terrible suffering to its employees, the families of its employees and the members of the public who were exposed to it".
> " - - - we must be able to lift the corporate veil[80] to ensure that corporations can't shirk there social responsibilities any longer, especially to those suffering the effects of their deadly products or processes".[81]

David Jackson QC in Chapter 30 (The Future) of the Special Commission Report[82] under the heading 'Reform of the Law Concerning the Corporate Veil' makes the remark that "the circumstances that have been considered by this Inquiry suggest that there are significant deficiencies in Australian corporate law" (p 571) having earlier stated:

> "JHIL,[83] and JHI NV[84] as the successor to its assets, have received substantial benefits from the business activities of Amaba and Amaca, including activities in the period in which those companies were dealing in asbestos so as to cause the diseases which now and in the future will give rise to claims. - - - To put it directly JHI NV still has in its pockets the profits made by dealing in asbestos, and those profits are large enough to satisfy most, perhaps all, of the claims of victims of James Hardie asbestos. And, as I have said in other Chapters, the causes of action now arising are by

[78] Personal Liability for Corporate Fault, May 2005 submission closing date 12 August 2005. The important distinction is drawn in the Discussion Paper between derivative liability and accessorial liability; the latter involving complicity.
[79] Press Release No. 009 22 March 2005
[80] "So-called lifting or piecing the veil is a picturesque label to describe what happens when, for reasons of public or statutory policy, the courts are able to identify classes of cases where corporate form is not decisive to the applicability of a statute or a common law doctrine". Lord Cooke of Thorndon, "Corporate Identity" (1998) 16 *Company and Securities Law Journal* 160 at 161.
[81] 16 March 2005, Monash University: Workshop on the Social Responsibility of Directors.
[82] Report of the Special Inquiry into the Medical Research and Compensation Foundation, September 2004.
[83] formerly James Hardie Industries Limited.
[84] James Hardie Industries NV; the substitution of this Dutch company for JHIL as a scheme of arrangement under s 411 of the Corporations Act is described in Chapter 2 of the Special Inquiry Report.

> reason of negligent conduct which took place during the period when profits were being made from asbestos." (p 555)

A clear distinction needs to be maintained between the largely benevolent and evolving concept of corporate social responsibility and the critical problem described by Jackson QC, such that responses in relation to the latter should be highly targeted to the mischief identified and not interfere with the broader evolving nature of the corporations law.

CPA Australia has not addressed the specific aspects identified by Jackson QC regarding possible interaction of the James Hardie events with the Chapter 5 external administration mechanisms of the Corporations Act in this submission, but can provide comment if requested by the Committee. The particular aspects being considered briefly in our submission are Jackson QC's reference to the 'corporate veil' within corporate groups, and the developments which might occur to lift the corporate veil in consequence of "contemporary public expectations and standards".

Academic literature on the topic of lifting the corporate veil identify the following five grounds:

- fraud;
- sham;
- avoiding legal obligations;
- breach of fiduciary duty; and
- agency.

The 'agency' grounds which, as implied by the terminology, attributes the acts of one entity to another, has recently been examined at length in the academic literature, within the specific context of James Hardies[85] An alternative, though perhaps more controversial path worthy of examination is that of the avoidance of legal obligations. An interaction between actual or anticipated exposure to obligations at tort and limited liability has at least in the United States attracted considerable academic consideration:

> " - - - strong empirical evidence indicates that increasing exposure to tort liability has lead to widespread reorganisation of business firms to exploit limited liability to evade damage claims".[86]

After examining corporate or industry disaggregation as an evasion strategy, the authors go on to propose a radical response; that of a genuine regime of unlimited shareholder liability arguing that:

> "It is common today to think of limited liability as an integral part of the corporate form and therefore to feel that abolishing limited liability, even in tort, would be recklessly revolutionary. But limited liability in both tort and contract evolved over the past 150 years did not become universal even in the United States until about fifty years ago".[87]

Development along the lines suggested by these American academics is likely to be untenable in Australia. However a less dramatic approach more reflective of the notion of lifting the corporate veil may be with reference to development of the law around recognition of joint tortfeasors. This might be applied either within corporate ground or where a disaggregation/restructure can reasonably be linked to an avoidance of a legal obligation. Here again however legal development is complex and even confused, though the comments of Redlich J[88] made in the context of director personal liability for tortious acts are noteworthy:

> " - - - where a director expressly directs or is party to the commission of a tort, the director will be liable and cannot in such circumstances rely upon the doctrine enunciated in *Salomon v A Salomon Co L*td". (at [85])
> "Where two or more people act together in furtherance of a common design to commit a tort they will be responsible as joint tortfeasors. Principal and agent may be joint tortfeasors. - - - Directors may be held liable as joint tortfeasors with their company. At least since *The Koursk*, it appears to have been accepted that a director who is the mind and the will of the company and the company may be joint tortfeasors because, as Scrutton LJ says, there is "one tort committed by one of them on behalf of, or in concert with another"". (at [102])

[85] J Harris, "Lifting the corporate veil on the basis of an implied agency: A re-evaluation of Smith, Stone and Knight" (2005) 23 *Company & Securities Law Journal* 7.
[86] H Hansmann and R Kraakman, "Towards Unlimited Liability for Corporate Torts" (1991) 100 *Yale Law Journal* 1879 at 1881.
[87] H Hansmann and R Kraakman, "Towards Unlimited Liability for Corporate Torts" (1991) 100 *Yale Law Journal* 1879 at 1923.
[88] *Johnson Matthey (Aust) Ltd v Dascorp Pty Ltd & Ors* (2003) 9 VR 171.

A final perspective on piecing the corporate veil briefly addressed by Jackson QC is that of a denial of the defence of limited liability in cases of "under-capitalisation". Developments in this direction likewise raise their own complexities, though the conclusions drawn are highly relevant:

> "The existence of the doctrine in the United states suggests that significant inroads can be made into the corporate veil doctrine without undermining international competitiveness". (at 575)

To reiterate the comments above, whilst development of a more coherent basis for lifting the corporate veil is well overdue reform in this direction needs to be targeted and predictable so that the vast majority of incorporated businesses whose directors adopt fair and ethical standards of conduct are not discouraged from engaging in reasonable business risk.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and / or their directors.

Summary of conclusions:

- A proactive approach towards voluntarism from business negates to a degree the risk of attracting excessive and inflexible obligations.
- The unique nature of individual businesses and their networks of evolving stakeholder interests does not lend itself to 'one-size-fits-all' mandated solutions.
- A substantial section of Australian business is currently ill prepared to implement a process of non-financial information disclosure – development in this direction would need to be carefully planned, particularly if a particularly prescriptive approach were taken.
- A full appreciation of the role of building capacity in relation to the management of social and environmental information, not merely as an adjunct to external reporting, is vital to the development of capacity to manage non-financial risk.

5.1 Voluntary Vs Mandated Approaches

Central to this issue are critical questions as to the direction, nature and weight of any mandated regulation that may emerge seeking conversely to either encourage or compel corporate behaviour and management decision-making towards consideration of stakeholder interests. If there are highly persuasive pressures that compel sensitivity to the impact of business on external interests, supported by sound business rationale, a degree of proactive involvement by business is likely to generate better regulatory outcomes for itself:

> " - - - if corporations cannot accept responsibility for the consequences of their actions and decisions, then they will increasingly be obliged to play by rules that are progressively imposed upon them".[89]

The critical question is whether corporate social responsibility and stakeholder engagement are types of behaviour that lend themselves to highly prescriptive regulation or a more principle based set of solutions potentially expressed in guidance with a level of legislative weight. CPA Australia is not seeking a minimalist least intrusive outcome, but reflects both the inappropriateness of a 'one-size-fits-all' solution to firm specific relationships and the current level of development of non-financial disclosure as part of stakeholder engagement.

Academic literature dealing with political theory of corporate social responsibility and with the strategic dimension to sustainable development respectively allude to this complexity:

- "It seems - - - that the basic question of corporate social responsibility is not whether we wish to compel or forbid certain kinds of corporate conduct by legislative command - - - but rather whether it is socially desirable for corporations organised for profit voluntarily to identify and pursue social ends where the pursuit conflicts with the presumptive shareholder desire to maximise profit".[90]
  and further;
  "The social and economic desirability of these two subspecies of corporate voluntarism - disclosure, and abstention from interference with lawmaking – is an extremely complicated question and, again, **the answer may vary with different types of disclosure and different types of interference with lawmaking**".[91] (emphasis added)
- " - - - sustainability development practices are a sub-set of business practice engaged in to achieve sound strategy and performance outcomes. **There is no single set of sustainable development practices because every firm has a unique business strategy**".[92] (emphasis added)

Common to both these perspectives is the notion of linkages between stakeholder engagement and the role of information by which the interests of third-parties are balanced with those of the company as part of decision-making processes within the context of corporate responsibility. Engel describes the circumstances that prevailed in 1980, of which a number of observations[93] regarding disclosure are still highly pertinent:

[89] R. Sarre, "Responding to Corporate Collapse: Is there a Role for Corporate Social Responsibility?" (2002) 7(1) *Deakin Law Review* 1 at 13.
[90] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1 at 3.
[91] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1 at 5.
[92] "Sustainable Development and Business Success: Reaching beyond the rhetoric to superior performance", Foundation for Sustainable Economic Development University of Melbourne, March 2005 at 7.
[93] D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1 at 5.

- whilst a widening scope of disclosure as a social good may seem intuitively appealing, its collection and dissemination comes at an often considerable cost,
- there exist a very real risk of 'drowning the recipient in information', and
- absent wide acceptance of such practices, overall information utility can be degraded by non-participants.

It is reasonable that these problems are redressed within the various non-financial information reporting frameworks that have emerged, and continue to evolve, though these practices are still in a state of relative infancy, particularly when compared with formality of financial reporting. Currently there is no framework for gauging the information/decision value of these disclosures amongst recipients.

5.2 Approaches for the recognition of third-party interests

Looking at approaches to build awareness of third-party interests, two avenues are identified by Parkinson;[94]

- reliance on *managerial voluntarism* and
- enabling an *empowerment of interest groups* to shape company conduct.

Both strategies have impediments to full realisation. The first is predicated upon reorientation of managerial attitude, whilst the second more problematically, presents issues of balancing potentially unequal power. In pursuit of the former less radical redirection of corporate behaviour, Parkinson adopts a different perspective on the role of information as an 'external stimulus' to *managerial voluntarism.* The focus is primarily on inward flows of information and away from the frequent starting point in the debate around the meeting of wider stakeholder interests – that of disclosure requirements:

> "the mere fact of being under a duty to disclose information is not in itself a reason for companies to change their behaviour".[95]

A range of benefits[96] of responsible corporate behaviour flow from strengthening competency to collect and analyse information about the impact of business operations on third parties:

- increased capacity for compliance with substantive law by either encouraging or compelling, where appropriate, possession of certain types of information,[97]
- provide a motivation for establishment and scrutiny of compliance with risk management procedures/systems, and
- facilitate a greater degree of reasoned sympathy, and hence capacity for responsiveness, in relation to the impact of the conduct of business on the social and physical environment.

Parkinson goes on to present a number of plausible arguments in favour of an obligation to disclose;[98] the key rationale being that the discipline necessitates collection - the improved information flows thus causing management to limit avoidable damage to third parties. The recognition of what is termed 'social monitoring'[99] which alludes to a widening array of formal and informal groups which interpret and critique information disclosed in the public domain is also significant.

The critical gaps in enabling broader adoption of stakeholder-based disclosures and the capacity to define the nature and format of any mandated frameworks of disclosure that may emerge in this domain are:

- firstly, an appreciation of the extent and characteristics of current practices amongst what are largely 'early adopters', and
- secondly, and more substantively, the impediments to both wider adoption and essential verifiability created by the absence of applied frameworks through which non-financial information is gathered, analysed and assimilated for reporting purposes.

[94] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 346.
[95] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 372.
[96] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 368-369.
[97] It is noted here our reference in response to Terms of Reference (d) to a strong preference for social and environmental objectives being pursued through direct legislation external to the Corporations Act.
[98] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 373.
[99] J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 373. Development in this area has been significant with the emergence of, for example a specific CSR category within the Australasian Reporting Awards and establishment of rating type approaches such as REPUTEX.

Both these aspects are the subject of extensive ongoing research being conducted jointly by CPA Australia and the University of Sydney; results from which and foreshadowed future directions are described in response to Terms of Reference (f) and (g).

It is appropriate to conclude with some brief reference to the inappropriateness of 'command and control' type regulation in the realms of corporate social responsibility and its adjunct of information flows as a source for encouraging managerial voluntarism and more open organisations. Given that what is being dealt in stakeholder engagement are matters very specific to the individual company and are a function of a more enlightened management, highly prescriptive approaches are potentially ineffective:

> "For businesses that have very little willingness to be responsible to start with, legalistic command-and-control regulation invites evasion through loopholes and 'creative compliance'. Overtly technical rules can also increase non-compliance by encouraging evasion and creative adaptation".[100]

[100] C Parker, *The Open Corporation: Self-regulation and Democracy* (CUP 2002) p 10.

f) The appropriateness of reporting requirements associated with these issues.

Recommendations and summary of conclusions:

Empirical research conducted by CPA Australia and the University of Sydney reveals:

- Despite the notion of triple bottom line reporting having been widely considered for more than a decade and a half, its extent and duration of penetration in Australia is quite limited.
- Reporting frameworks and standards were generally not adopted and verification of the stand-alone TBL reporting was sporadic at best.
- Some disclosures may be viewed opportunistically by management with evidence of a biasing towards 'positive' information.
- The decisions to adopt wider stakeholder disclosure practices is often influenced by competitor behaviour.

Consistent with the approach described in response to Terms of Reference (e) which emphasises the idea of information flows as a basis for stimulating 'managerial voluntarism' the following conclusions are made:

- The evident gap and pressing need for development is in the realms of internal accumulation, measurement and analysis of environmental and social data.
- Improved social and environmental outcomes will be facilitated through the flow and utility of information which is essential to improve resource allocation and decision making.
- Through these means stakeholder engagement and participation will be nurtured.
- Developments in accuracy, retrieval and verifiability of non-financial information will facilitate and strengthen the alternative path to improved social and environmental performance reporting; that of voluntary disclosure conducted within overarching principle based guidance.

6.1 An empirically based assessment of the development of Triple-bottom-line reporting in Australia

Given the considerable literature and diversity of views around the notions of sustainability and TBL, in 2004 CPA Australia commissioned the University of Sydney to undertake research to achieve a greater degree of verifiable clarity on the types of current practice and characteristics of adopters, the information value of non-financial stakeholder disclosures and possible wider association with corporate governance and related organizational behaviour.

The project had the following principle objectives:

1. *To identifying and clarify the interface/interaction between traditional financial based accounting disclosures and sustainability/TBL oriented information.*
2. *To enable the articulation of a policy perspective on the role of accounting information and accountants in either advancing or supporting sustainability/TBL initiative.*
3. *To provide an empirically based assessment of the actual or potential market, governance and institutional strengthening impact of sustainability/TBL initiatives.*

To achieve these objectives the following specific research tasks have been carried out:

- a survey of current TBL practices in Australia. The aim was to determine the extent and mode of TBL disclosure from public companies, government business enterprises (GBEs) and public sectors departments/agencies such as local council authorities.
- an analysis of the portfolio performance of TBL disclosing firms and 'ethical' funds. The aim was to determine trends in the market performance of individual firms which adopt sustainability disclosure practices and to track the performance of funds which have a primary mandate to invest in ethical/socially responsible companies.
- investigation of capital market response to TBL disclosure. The aim was to determine the price and trading response to sustainability/TBL disclosures.
- assessment of the TBL corporate governance relationship. The aim was to determine whether there exists any association between adoption/disclosure of sustainability/TBL and management practices which reduce risk of corporate distress/failure.

Summaries and a detailed report of the research findings, released in August 2005, are attached. Most significant to the Committee's Terms of Reference is the finding that, despite the notion of triple bottom line reporting being widely considered for more than a decade and a half, its extent and duration of penetration in Australia is quite limited. This is notwithstanding the emergence of some exceptionally high quality reporting as evidenced by the content in the Environmental Reporting, Occupational Health & Safety Reporting and Corporate Governance categories of the Australasian Reporting Awards.[101] Many of those that do report well would also have adopted an approach of continual improvement to their disclosure practices.

Consistent with the relative infancy of reporting practices, reporting frameworks and standards were generally not adopted and verification of the stand-alone TBL reporting was sporadic at best. The quality of TBL disclosure in Australia is undermined by the fact that such disclosures may be viewed opportunistically by management with evidence of bias towards 'positive' information. The decision to adopt wider stakeholder disclosure practices is often influenced by competitor behaviour with the quality, consistency and breadth of reporting nonetheless heavily determined by chief executive commitment.

6.2 The requirements to enable wider take-up and improvement in the quality of TBL reporting

Drawing from the outcomes of this research, the evident gap and pressing need for development from the perspective of accounting practice is in the realms of internal accumulation, measurement and analysis of environmental and social data. Development in these directions would not only support the rigor, meaningfulness and verifiability of TBL reporting, but allow these factors to be given their proper regard in financial decision making and risk analysis.

It is on this basis that a collaborative partnership between CPA Australia and the University of Sydney successfully sought Australian Research Council Linkage Grant funding to undertake an applied cross-disciplinary research project over three years titled "The role of accountants and accounting in improving sustainability management and reporting".

In developing the research proposal, the University and CPA Australia were cognizant of wider developments and sought to identify avenues for greatest contribution – as such, acknowledging substantial progress made in the development of reporting models and frameworks[102] and the leadership role likely to be taken by International Federation of Accountants in the realm of audit and assurance[103] of TBL type reports.

The wider "philosophical" context within which the research would be undertaken

As the debate around mandating of environmental and social performance disclosure and the legal formalisation of corporate social responsibility unfold in the coming months and years, this project will potentially ease the burden on business and government by developing a rigorous framework for classifying, measuring and reporting various forms of sustainability information. It is expected the research will produce improved social and environmental outcomes by facilitating the flow and utility of information essential to improved resource allocation and decision making. Significantly, the contemplated methodologies will address:

> firstly, the complexities associated with the identification and measurement of the 'up-steam' and 'down-stream' environmental consequence of an organisation's activities within a value chain,[104] and
>
> secondly, the assessment of environmental costs across the life-cycle of a product.[105]

A broader outcome will be to enable benchmarking of performance within and across industries and is highly consistent with the approach described in our response to Terms of Reference (e) which describes strengthening inward flows of information.

Whilst there is obvious appeal in the idea that an organisation should be fully accountable for its social and environmental consequences, and should report on performance in these additional dimensions of business

[101] www.arawards.com.au

[102] It is noted without endorsing as the ideal model, the framework contained in the Global Reporting Initiative which has emerged as preferred framework amongst many adopters both here and overseas, and that further, the third 'generation' of the GRI and its constituent indicators is due for release in 2006.

[103] A global comparison of Triple Bottom Line assurance reporting can be found ay http://www.cpaaustrali.com.au/01_information_centre/26_tbl/1_26_0_0_tbl_index.asp

[104] The GRI identifies these issues in its draft Boundary Protocol (September 2004).

[105] see for example Plieger, Fischer, Kupfer and Eyerer "The contribution of life cycle assessment to global sustainability reporting of organisation" (2005) 16(2) *Management of Environmental Quality: An international Journal* pp. 167-179.

activity alongside its traditional financial statements, the extent such disclosure can be mandated is highly contentious.

One of the more forceful voices urging this formality is Professor Carol Adams of Deakin University; who has stated:

> "As companies rush to prove their corporate citizenship credentials through ethical, social and environmental reports, many such reports are not worth the paper they are written on"
>
> "There need(s) to be mandatory reporting guidelines and a radical overhaul of corporate governance systems."
>
> "The lack of accountability and incompleteness demonstrated by many reports would never be tolerated in financial reports. It begs the question why we tolerate it in social and environmental reports when the impact of these activities last much longer."

CPA Australia argues that developments in accuracy, retrieval and verifiability of non-financial information that emerges from projects like the ARC Linkage Grant research, will facilitate and strengthen the alternative path of voluntary disclosure conducted within overarching principle based guidance to improved social and environmental performance reporting.

While It is uncertain where such guidance might emerge, it is noted that both Professor Boymal, chairman of the Australian Accounting Standard Board and Senator Campbell, the Minister for the Environment and Heritage commenting in relation to the ASX Corporate Governance Best Practice Recommendations, have indicated the need for development in this direction. The format of such a framework is not yet foreshadowed at this early juncture, though CPA Australia urges wide and reasoned consultation.

With the University of Sydney research showing TBL reporting type practices to be in their infancy with relatively narrow sectoral "take-up", a highly prescriptive mandatory scheme may be premature. Self-regulation will possibly offer businesses the capacity to report to stakeholders within an appropriately defined framework, once equipped in the manner contemplated by the future research,. Outcomes of commitment and performance are more likely to be achieved where the participants engage in a voluntary manner.

g) Whether regulatory, legislative or other approaches in other countries could be adopted or adapted for Australia.

Summary of conclusions:

- Typical of an emerging area of regulation, approaches are fragmented and derived from a range of sources, therefore a greater level of harmonization and coordination between corporate, environmental, labour and associated social regimes is warranted.
- Australia is equally well placed as the United Kingdom, its most comparable jurisdiction in terms of corporate regulation, to build upon its existing regulatory regimes and structure of guidance to achieve a higher standard of disclosure of the non-financial performance of its corporations.
- Aspects of a more enlightened understanding of the wider role and responsibility of companies and their managers cannot necessarily be achieved by legislative and prescriptive approaches. Emerging solutions give appropriate weight to the role of information to both inform and encourage greater regard of stakeholder interests.

7.1 Regional comparisons

A facet of the research undertake by the University of Sydney on behalf of CPA Australia, was to conduct a regional review of regulatory and professional initiatives in accounting, auditing and governance to improve the transparency and management of the social and environmental aspects of entities' activities. Consideration was also given to whether such initiatives featured in broader regulatory initiatives aimed at providing economically viable and sustainable solutions to problems of financial distress in the Asia-Pacific region. Key findings included.

> The review follows a period of substantial reform of financial reporting and securities market regulation and corporate governance practices throughout the Asia-Pacific region. These reforms were largely initiated in response to the Asian Debt Crisis of 1998, but in some countries the profile of these reforms was subsequently elevated by the widespread ramifications of the collapse of Enron, Worldcom and other multi-national corporations.
>
> Very few legislative requirements for the disclosure of social and environmental information exist. The few instances of disclosure requirements that were identified were piecemeal and narrowly defined.
>
> The corporate governance codes introduced in Australia and India include general requirements for the disclosure of social and environmental information for a broader range of stakeholders. While corporate governance reforms were undertaken in each of the twelve jurisdictions included in this review, most were not mandatory and some made no reference to social and environmental information.
>
> Significant initiatives have been undertaken to improve the transparency of corporate activities and accountability for social and environmental impacts of operations in the Asia-Pacific region. They have mostly been in the form of voluntary guidelines and recommendations. The effectiveness of these initiatives is difficult to assess as most have been in operation for only a few years.
>
> Key players in social and environmental reporting reform are securities exchanges, securities commissions or councils involved in corporate governance reforms, governments, accountancy professional bodies, and commercial organisations, such as business councils and industry groups. Only very limited consideration has been given to the establishment of a conceptual framework within which of environmental accounting,[106] and more significantly standards relating non-financial reporting, could develop.
>
> However, the government initiatives involving treasury and financial ministerial portfolios have typically been in the form of corporate governance disclosure requirements or recommendations, or piecemeal mandatory disclosures in legislation. There are many key players working with different strategies toward a common goal of sustainable management of resources facilitated by enhanced accountability for social and environmental performance. There is a need for more collaboration among key players and co-ordination of developments in sustainability reporting to advance corporate transparency and accountability to a wider range of stakeholders.

[106] It is noted that the International Federation of Accountants has issued in 2005 its International Guidelines on Environmental Management Accounting (EMA).

7.2 UK developments

Two particular aspects are noteworthy:

- At the legislative level, a Bill is currently being considered to give formal recognition to a directors' capacity to take into account the likely impact of their decisions on the interests of other stakeholders. Earlier proposals to enable a director to place the interest of a stakeholder above that of a shareholder were rejected. Pending the opportunity to review the UK legislation and accompanying explanation, CPA Australia suggests this approach is neither necessary or appropriate.

- At the reporting level, in May the UK Accounting Standards Board issued a revised Reporting Standard (RS1) on the Operation and Financial Review (OFR). This standard, which has legal standing, includes a requirement for the directors' OFR to include information about a range of matters, including employees, environmental matters, and social and community issues, with analysis using key performance indicators. The Board's own press release notes that they have not specified any mandatory disclosures in these areas, recognising that directors need to judge what is required for their business. Further significant aspects of this development are that the OFR is subject to audit and that it is acknowledged that the 'audience' is that of shareholders rather than investor or wider base of interest.

The appropriateness or adaptability of these development to Australia is best understood in the context of both the impact of current disclosure requirements and where current trends, such as with the evolving basis of the ASX Principles of Good Corporate Governance, might be heading. Within the Corporations Act itself, two sections are considered:

- s 299(1)(f)[107] requires company directors to report on performance in relation to any significant environmental legislation as part of their annual review of operations and activities, and
- s 1013DA which foreshadows the development by ASIC of obligatory guidelines for the disclosure of social, ethical or environmental considerations in Product Disclosure Statements in relation to the issue and sale of financial products.

Longitudinal research conducted by Karen Budna-Litic of the University of Technology Sydney[108] concludes that "the quantity of environmental reporting by Australian companies has increased over the past four years, indicating support for continued regulation of environmental disclosure by publicly listed companies" despite an apparent tendency to disclose at a minimal level that might fall below a threshold of significant usefulness to stakeholders,.

A further observation made by Budna-Litic concerns the relatively prescriptive nature of the guidelines ultimately promulgated by ASIC in relation to s 1013DA. Whilst the Guidelines are highly targeted in nature with Product Disclosure Statements and hence a well defined basis of investor interest, there may be some scope for adaptation of at least the philosophy and parts of the content of the Guidelines to both s 299(1)(f). Similarly, the approach adopting in the Guideline might also in application of particular facets of Principle 10[109] of the ASX Principles and Best Practice Recommendations.

[107] Pt 2M.3 – Div 1 – Annual financial reports and directors' reports
[108] "The Thin Green Line" reports summarised and commented upon in Keeping Good Companies the journal of Chartered Secretaries Australia, November 2004 pp 615-617.
[109] Recognise the legitimate interests of stakeholders.