Total Environment Centre, Green Capital Program Submission to the Inquiry into Corporate Responsibility

TOTAL ENVIRONMENT CENTRE

Responses to the terms of reference

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

In our experience, a minority of decision makers have any regard for stakeholders, and of this minority only a handful have *adequate* regard for stakeholder interests. This has been our experience as an environmental advocacy organisation and stakeholder for over 30 years, who in the last three years has run the Green Capital program which is dedicated exclusively to advancing corporate sustainability. The research by BT Governance Advisory Service in their submission to this inquiry supports our view.

The good news is that the proportion of businesses that do have regard for stakeholder interests issues is growing, albeit at a rate not fast enough to address the many pressing environmental and social issues of our time. In recent years TEC has witnessed a small but growing number of corporations who have sought to increase the extent to which stakeholder interests are considered through finding creative, more holistic ways in which stakeholder concerns become financial concerns such as;

- recognizing their ‘social licence to operate’ or ‘community risk’,
- understanding risks and opportunities to the value of their corporations reputation,
- regulatory risks created if stakeholder interests or ‘community risks’ are not addressed,
- identifying future risks and opportunities through consultation with stakeholders, and
- understanding that being responsible makes them a ‘employer of choice’.

These approaches are often coupled with moves to take a longer-term view, since stakeholder concerns are often longer term than narrow financial ones. This more holistic approach to directors’ duties is welcomed by TEC, but we have witnessed limitations to this approach which include;

- despite the more broader definitions, the public interest and a corporations best interests can still conflict, and the corporations interests remain primary
- a small number of businesses adopting this approach
- only institutional investors such as superannuation funds have sufficiently long term incentives to enable these approaches to be adopted
- businesses willing to accept a high risk of acting against stakeholder interests if there is sufficient financial returns
- businesses managing sustainability risks not though reduction of the risk at the source, but by reducing their exposure to the risk. For example, lobbying for exclusion from an emissions trading scheme can be viewed as a legitimate approach to reducing exposure to climate change risk
- difficulties in translating stakeholder interests that have intrinsic value (such as wilderness or human rights) into financial value. This often results in under-valuing of an environmental or social cost of benefit, which weakens the business case.
- Confusion over responsibilities (such as smog from car use, which involves individual drivers, car manufacturers, petrol manufacturers & government regulation and tax structures)
- Market failures, particularly where costs to society or the environment remain ‘externalised’

For these reasons, TEC believes that the status quo is not sufficient, even with a broader interpretation of directors’ duties than the dominant culture.

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

For decades corporations and governments have acted in their own short term financial or political interests at the expense of a sustainable society and environment.

TEC argues that the terms of reference should be broadened to consider the extent to which decision makers should have regard for stakeholders and the social and environmental sustainability of society.

Corporations should not simply ‘have regard for’ or ‘manage’ stakeholder expectations. Such language is often paternalistic or tokenistic. TEC believes that organizational decision-makers should;

1. be able to have full regard for stakeholder interests, even when not in the best interests of shareholder or the corporation,
2. not act at the expense of stakeholders, society or the environment
3. act in accordance with the precautionary principle, which requires decision makers to rigorously rule out negative consequences before they act

TEC and many other community organisations have spent decades agitating for issue specific legislation to prevent corporations and governments acting in their own interests at the expense of society and the environment. A more systematic approach to sustainability would reduce the seemingly endless need for ‘firefighting’ to prevent environmental or social damage.

After 30 years of campaigning, TEC does not expect to see the goals described above to be achieved quickly, and so we support a number of interim measures described in response to questions (c) to (g)

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.

Although some more enlightened corporations do not see the current legal framework as discouraging consideration of stakeholder interests, James Hardie clearly does. Regardless of the legal interpretation of corporations law, the dominant cultural interpretation of directors’ duties is a narrow financial one.

The perceived ambiguity of directors’ duties tends to re-inforce the status quo, discouraging the majority of directors from having regard for stakeholders interests.

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 obligations that exist in laws other than the Corporations Act.

TEC believes that corporations law does need reform, most likely in stages. In the short term, the ambiguity surrounding directors’ duties and stakeholder interests should be removed by changing section 181 of the Corporations act to explicitly allow directors to consider stakeholder interests, even when these interests are not in interests of shareholders or the corporation. Such a clarification has been variously suggested by the ACF submission amongst others.

In the longer term, TEC believes that the Corporations Act be changed such that a director of a corporation must discharge their duties in the best interests of the corporation (as is currently the case) but not at the expense of the sustainability of society or the environment. Bob Hinkleys submission is the source of this concept and is supported in principle by TEC.

Many have said that a change to the corporations act will create a compliance culture, without the benefits of competition and innovation that business is very capable of. In TEC’s opinion, regulation often creates a minimum standard, but rarely inhibits competition and innovations for those businesses willing and able to do better. The above suggestion does not prevent businesses competing on how responsive they are to stakeholder interests, nor on how well they manage sustainability risks. If we wanted to regulate *above* the minimum standard, we would suggest that directors primary duty be to act in the public interest and secondarily in the best interests of the corporation.

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

There are a range of regulatory and voluntary measures that TEC supports not as an end point or complete solution, but as steps along the path to corporate sustainability;

Legislating to protect intrinsic values
Some values held by society are viewed as having intrinsic, un-quantifiable value. Species loss, wilderness areas and basic human rights should not have a financial value attached to them in order to protect them. TEC and other groups have done and will continue to advocate direct protection of these values, rather than protection via various market based instruments.

Internalise environmental and social externalities
In many instances, corporations make decisions for their financial benefit largely because the market has failed to adequately value environmental assets. Using a financial analogy, this market failure can lead to environmental 'asset raiding'. Governments need to correct market failures so that businesses can take into account stakeholder, social and environmental interests without having to undergo a change in corporation law or business culture. Priority actions include;

1. Remove perverse subsidies to environmentally harmful industries
2. Create a cap and cost for greenhouse gas emissions
3. Reflect the true health, congestion and societal costs of motor vehicle use in the price of petrol, road use and road vehicles
4. Implement cost reflective pricing for urban and rural water use

The financial costs of these externalities need not reflect the marginal cost of abatement, but can be a true reflection of the long-run costs to society and the environment.

Support for voluntary programs
Provided that the programs have increased consideration of stakeholder interests as a real outcome, voluntary programs should be supported by business, government and NGO's. Initiatives and groups such as the Institutional Investors Group on Climate Change[1], the Enhanced Analytics Initiative[2], the United Nations Environment Program Finance Initiative[3] and the Carbon Disclosure Project[4] all warrant increased support, not as an alternative to other mechanisms, but as complementary initiatives.

Lift the minimum standard of reporting
Public reporting of sustainability risks, impacts and benefits is required for stakeholders and the broader community to meaningfully articulate their interests. Without mandatory reporting, only corporations with good non-financial performance publicly report on their performance. Reporting requirement similar to the UK Operating and Financial Review (OFR)[5] requirements should be implemented in Australia.

Support higher levels of voluntary reporting
Supporting higher level reporting on a voluntary basis does lead to better reporting and does help to change business culture. Government programs that support reporting to GRI[6] standards would encourage first time reporters. Increased promotion and adoption of the ASX Corporate Governance Guidelines[7] would also be beneficial.

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

As discussed in the previous question, existing mandatory reporting requirements need to be lifted, and voluntary initiatives that report to higher standards should receive government support.

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

The reporting requirements created by the UK (OFR) should be adopted in Australia. These reporting requirements require reporting on stakeholder interests such as environmental and social and community issues. Requirements in item 29 is of particular relevance to this inquiry. TEC would support similar disclosure requirements as part of the lift in minimum standards for reporting discussed in the previous question.

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[1] http://www.iigcc.org/

[2] http://www.enhancedanalytics.com/

[3] http://www.unepfi.org/

[4] http://www.cdproject.net/

[5] www.asb.org.uk/images/uploaded/documents/Web optimized OFR REPORTING STANDARD.pdf

[6] The Global Reporting Initiative http://www.globalreporting.org/

[7] http://www.asx.com.au/about/pdf/ASXRecommendations.pdf

About the Total Environment Centre and Green Capital

The Total Environment Centre is a non-profit community organisation that has been campaigning on a wide range of environmental issues for over 30 years. The organisation has worked on issues such as wood chipping, native forests, water, energy, transport and chemicals.

In 2002 TEC recognised that it needed to engage with the business sector on issues of sustainability with a view to ensuring business became more sustainable. It established the Green Capital program for that purpose, which has now run 15 major events. In addition, research, training and advocacy projects have been run on specific issues of corporate sustainability. For more information, see www.tec.org.au