Dear Dr Marinac

Attached is a submission by the Public Interest Law Clearing House (Vic) Inc ('PILCH') to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Social Responsibility.

The submission examines the following questions:

(a) Should the current formulation of directors' duties be restated to encourage directors to take into account a broader set of interests when making corporate decisions?

(b) What other corporate governance measures should be adopted to encourage CSR?

(c) Should companies be required to report on their CSR performance? If so, what information should the reporting contain, and what form should it take?

(d) How could institutional shareholders be required to respond to the CSR demands of indirect shareholders?

(e) Should the Government impose CSR standards upon companies providing goods and services to Government?

The submission makes 12 recommendations to the Committee.

PILCH would appreciate the opportunity to supplement this submission with oral testimony at any public hearings.

Yours sincerely

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# Corporate Social Responsibility and the *Corporations Act 2001*

## A submission to the Parliamentary Joint Committee on Corporations and Financial Services ('Committee')

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# 1. Summary

## 1.1 About PILCH

The Public Interest Law Clearing House (Vic) Inc ('**PILCH**') is a non-profit, independent legal service based in Melbourne. PILCH co-ordinates the provision of pro bono (without fee) legal assistance to non-profit and community organizations and to marginalized and disadvantaged individuals and groups across Victoria.

PILCH is associated with the Public Interest Law Clearing House Inc of New South Wales, and the Queensland Public Interest Law Clearing House,.

## 1.2 Overview

This paper discusses various concepts of corporate social responsibility ('**CSR**') and the current legal framework as it relates to CSR and discusses ways in which the law might be changed to encourage CSR. The paper uses the following questions as a basis for discussion of areas in which CSR might be encouraged:

(a) Should the current formulation of directors' duties be restated to encourage directors to take into account a broader set of interests when making corporate decisions?

(b) What other corporate governance measures should be adopted to encourage CSR?

(c) Should companies be required to report on their CSR performance? If so, what information should the reporting contain, and what form should it take?

(d) How could institutional shareholders be required to respond to the CSR demands of indirect shareholders?

(e) Should the Government impose CSR standards upon companies providing goods and services to Government?

## 1.3 Recommendations

PILCH makes the following recommendations to the Committee:

**(a) Recommendation 1**

The Committee should consider CSR broadly and look both at:

- decision-making that has regard to the interests of stakeholders other than shareholders; and
- acts of corporate philanthropy and social activism.

The Committee should be wary of considering corporate social responsibility to be limited to acts of philanthropy by companies. Although the Committee should acknowledge and encourage corporate philanthropy, the Committee should also consider ways it can encourage companies to take sustainability and social responsibility into account in their business and operational decision-making.

**(b) Recommendation 2**

The Committee should not view corporate social responsibility as a substitute for:

- appropriate legislation regulating companies' environmental and social performance; or
- the provision of adequately funded social services through government and not-for-profit providers.

**(c) Recommendation 3**

The formulation of directors' duties should be amended to follow the model used in the *Company Law Reform Bill 2005* (UK), which requires directors to consider interests other than the interests of shareholders where relevant and so far as reasonably practicable. A draft amendment to the *Corporations Act 2001* is set out at page 13.

**(d) Recommendation 4**

The Committee should encourage companies to adopt codes of conduct, containing statements of principle intended to govern the conduct of their affairs at all levels of decision-making. Companies' codes of conduct should apply equally to their Australian and overseas operations and should be backed up with appropriate internal compliance mechanisms.

**(e) Recommendation 5**

Companies should be encouraged to adopt a code of conduct by the introduction of a requirement that they disclose publicly their code of conduct, or disclose publicly their reasons for not adopting a code of conduct ('**comply or explain requirement**').

The comply or explain requirement should apply to all public companies and large proprietary companies, as those terms are defined in sections 9 and 45A(3) of the *Corporations Act 2001*. Draft amendments to the *Corporations Act 2001* are set out at page 17.

**(f) Recommendation 6**

Companies should be encouraged to refer to and use the UN Norms as a model when drafting their codes of conduct. A definition of 'code of conduct' for the *Corporations Act 2001* is set out at page 19.

**(g) Recommendation 7**

Public companies and large proprietary companies should be required to disclose all internal policies, manuals and other documents relating to their CSR performance on their website. Draft amendments to the *Corporations Act 2001* are set out at page 22.

**(h) Recommendation 8**

In addition to existing continuous disclosure obligations, listed companies should be required to make immediate disclosure of events having a material effect on the company's CSR performance.

**(i) Recommendation 9**

Public companies and large proprietary companies should be required to report, in their annual report, using the GRI Guidelines. Draft amendments to the *Corporations Act 2001* are set out at page 22.

**(j) Recommendation 10**

The 5% or 100 shareholder rule in s249D of the *Corporations Act 2001* should be retained as a mechanism by which shareholders are able to place resolutions before general meetings relating to the company's social and environmental performance.

The Committee should consider other mechanisms by which companies can be made more responsive to the demands of shareholders in relation to social and environmental performance.

**(k) Recommendation 11**

The Committee should consider ways in which superannuation funds, financial institutions and other large institutional shareholders can inform retail investors of any ethical, social and environmental principles that will be used to make investment decisions. In doing so, the Committee should have regard to the need for such information to be presented in an accessible way to enable retail investors to readily compare funds' policies with one another.

**(l) Recommendation 12**

The Commonwealth Government should introduce a policy of procuring only from companies whose CSR performance meets defined benchmarks.

## 2. Defining CSR

### 2.1 Levels of CSR

The term ‘corporate social responsibility’ is used broadly to describe a view of corporate governance which advocates the pursuit by companies of a broader range of objectives than simple profit-making. However, it is helpful to distinguish levels of corporate conduct that may be consistent with CSR.[1]

### 2.2 Compliance

Companies, like individuals, are subject to a wide range of legal obligations and regulation, some of them specific to business and industry sectors (for example, accounting regulations or product labelling requirements) and some of general application (for example, a duty to avoid injury to members of the public). On a conventional economic view, legal compliance might be seen as one of a number of costs to a business. On this view, it is in a company's best interests to adopt a narrow, minimalist view of its legal obligations, so as to limit costs whilst continuing to operate lawfully.

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[1] Therese Wilson, 'The "best interests of the company" and corporate social responsibility', paper presented at the Corporate Law Teachers Association conference, 7 February 2005, 4.

Although compliance with all applicable legal and regulatory obligations is fundamental to the practice of CSR, CSR goes beyond compliance in that it involves companies engaging in conduct not necessarily required by law which serves broader interests than the pursuit of immediate profit for shareholders. PILCH considers that corporate governance rules can be changed to promote a culture of corporate decision-making that goes beyond mere compliance and considers the long-term effects of a company's conduct, having regard to a range of external interests.

### 2.3 Sustainability

Companies are increasingly recognizing that their long-term profitability depends upon their business operations being sustainable. By most definitions, 'sustainability' means that a company must not only take care of operating factors that contribute to its short-term profitability, but do so in a way that preserves its ability to meet future needs, by taking into account social and environmental factors.[2]

In order to sustain its operations over the long term a company is not only required to manage risk and consider its direct operational needs in the future, but also to consider the well-being of the society and environment in which it operates. By taking account of its impact upon and relationship with society and the environment, a company can help preserve and enhance the 'external' conditions that are fundamental to its profitability, such as the natural resources, infrastructure, rule of law and intellectual capital from which it benefits.

### 2.4 Responsibility to stakeholders

The pursuit of sustainability will require a company to consider a variety of interests, including the interests of 'stakeholders' that are important to its long-term profitability. However, CSR might be said to go further than sustainability in that, by its terms, it suggests a company has a 'responsibility' to take into account the interests of stakeholders, as well as its shareholders. In this vein, Don Argus, Chairman of BHP Billiton Limited, has stated that a company's 'licence to operate' is conferred upon it by the communities in which it operates.[3]

Who are the stakeholders to whom a company owes responsibilities? Stakeholders might be limited to groups connected to the company by conventional legal relationships such as employees, suppliers, clients, and consumers or persons to whom a company owes a duty of care. Alternatively a company might view itself as having responsibilities to a broader group, whose interests are somehow affected by the company's operations, for example as a result of their involvement in secondary or service industries, as a result of effects on a shared environment or as beneficiaries of a social service provided by a private sector operator.

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2 See Sustainable Measures, *Definitions of Sustainability and Sustainable Development* at <www.sustainablemeasures.com/Sustainability/DefinitionsDevelopment.html>.

3 Don Argus, address to Edmund Rice Business Ethics Initiative, 19 May 2002, at <www.erc.org.au/busethics/articles/1036114283.shtml>.

## 2.5 Philanthropy and social activism

At its highest level, CSR might include the pursuit, by a company, of objects beneficial to society that are altogether unconnected to its commercial operations. Examples might include acts such as the making of donations to charitable organizations, allocation of staff or other resources to not-for-profit projects or companies taking a public stance on social issues.[4] Advocates of CSR frequently refer to the 'business case' for companies engaging in social activism. Nevertheless, there is no reason why CSR theory should not accommodate the possibility of acts of corporate philanthropy or idealism that have purely altruistic motives.

There are numerous laudable examples of companies engaging in philanthropic projects. PILCH itself could not operate without the support of the private legal profession. However, the generosity of the private sector does not excuse governments of their obligations to meet international human rights standards or to properly fund adequate social services. Companies are rightly discerning in their philanthropy. Their decisions about who to fund, understandably, will be influenced by the sympathies of directors, and the perceived consistency between the objectives of the organisation receiving the support and the values of the donor company.

Increasing not-for-profit organisations' dependency upon corporate philanthropy may result in an ad hoc patchwork of funding that favours not-for-profit organisations with 'acceptable', uncontroversial objectives. Organisations dealing with stigmatised or ethically complex issues need to be assured that governments will continue to provide adequate funding. At the same time, more established not-for-profit organisations could provide higher levels of service delivery for each dollar of funding if they were able to divert resources away from marketing activities designed to attract private sector assistance.

## 2.6 PILCH's observations in relation to CSR

PILCH acknowledges the significant capacity for companies and other businesses to have a real effect upon social and environmental interests. At the same time PILCH considers that governments bear the primary responsibility for ensuring that companies' conduct is consistent with their desired social and environmental standards and outcomes. Where Australian society determines that particular standards of conduct are expected, in order to protect environmental or social interests, Parliament should give clear expression to those standards in appropriate legislation, and not rely upon the discretion of company directors to make decisions consistent with those standards.

Australian companies, for their part, should adhere to the standards expected of them by the Australian community, both by way of compliance with applicable law and regulations, and by informing their decision-making with general principles consistent with the spirit of those standards. The standards should be the minimum applied to operations overseas as well as in Australia.

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[4] An example (albeit short-lived) was Microsoft Corporation's support for a bill banning discrimination against same-sex attracted people (see David A Vise, 'Microsoft Draws Fire for Shift on Gay Rights Bill' *The Washington Post*, 26 April 2005, at <www.washingtonpost.com/wp-dyn/content/article/2005/04/25/AR2005042501266.html>).

**Recommendation 1**

The Committee should adopt a broad definition of corporate social responsibility incorporating:

- decision-making that has regard to the interests of stakeholders other than shareholders; and
- acts of corporate philanthropy and social activism.

The Committee should be wary of considering corporate social responsibility to be limited to acts of philanthropy by companies. Although the Committee should acknowledge and encourage corporate philanthropy, the Committee should also consider ways it can encourage companies to take sustainability and social responsibility into account in their business and operational decision-making.

**Recommendation 2**

The Committee should not view corporate social responsibility as a substitute for:

- appropriate legislation regulating companies' environmental and social performance; or
- the provision of adequately funded social services through government and not-for-profit providers.

## 3. The Inquiry's Terms of Reference

### 3.1 What is under consideration?

The Inquiry's Terms of Reference ask the Committee to consider revisions both to:

- the legal framework; and
- particularly … to the *Corporations Act 2001*

and invites the Committee 'to have regard to obligations that exist in laws other than the *Corporations Act 2001*'.[5] Despite the breadth of the phrase 'the legal framework', PILCH assumes that the Committee intends to focus on corporate governance, and the *Corporations Act 2001*.

### 3.2 Why look at the Corporations Act 2001?

PILCH considers that reform to the *Corporations Act 2001* is only one of a number of ways the Government can legislate to improve the environmental and social aspects of corporate conduct. A vast number of other laws (for example, planning laws, consumer protection laws, environmental protection laws, workplace relations laws) regulate companies' interaction with stakeholders in both the narrow and broad groups identified above. However, PILCH acknowledges that most of these laws fall

[5] This is in contrast to the earlier reference to CAMAC (see above n 1) which appeared to be limited in scope to revision of the Corporations Act.

outside the scope of the Inquiry and, on that basis, proposes to deal only with amendments to the *Corporations Act 2001* and the corporate governance framework more generally in this submission.

The *Corporations Act 2001* is relevant to CSR because it sets up the governance framework for companies. The *Corporations Act 2001* makes directors accountable to the company and, indirectly, to shareholders, for their decisions. The question raised by advocates of CSR is whether corporate governance rules should not also make directors accountable for the impact of a company's activities on a broader set of interests.

## 4. A New Formula for Directors' Duties

### 4.1 The current formula for directors' duties

Section 181 of the *Corporations Act 2001* provides that directors and officers of a corporation must exercise their powers and discharge their duties:

- in good faith in the best interests of the corporation; and
- for a proper purpose.

The conventional interpretation of the phrase 'the best interests of the corporation' is a narrow one in that the scope of interests that may be taken into account is limited to the interests of the company's shareholders taken collectively.[6]

Accordingly, directors will be acting in breach of their duties unless they are satisfied that a decision that advances the interests of groups other than shareholders is ultimately in shareholders' best interests.[7] In many cases, a decision of this type will be uncontroversial, such as a decision to offer generous conditions to attract and motivate employees or to improve environmental practices to avoid adverse publicity. This means it is at least arguable that 'sustainable' decision-making is consistent with the current formulation of directors' duties in the *Corporations Act 2001.*

Difficulty arises under the *Corporations Act 2001* where directors contemplate conduct not required by law that favours broader community interests, where doing so may have an adverse effect upon shareholders' financial interests.

**Example: the James Hardie group restructure**

The restructure of the James Hardie group was the subject of the Jackson judicial inquiry in New South Wales in 2004. One of the corporate entities in the James Hardie group had potentially very large liabilities to compensate sufferers of asbestos-related medical conditions, because of its history as a manufacturer of asbestos products. The board of James Hardie Industries Limited approved a series of intra-group transactions the effect of which was to separate and insulate

6 Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005), [8.095]. An exception to this is that directors have been found to owe duties to creditors in circumstances where a company is insolvent or is facing insolvency (ibid, [8.100]).

7 *Woolworths v Kelly* (1990) 4 ACSR 431.

the parent company from the former asbestos-producing subsidiary.

The Jackson report found that as a result of the transactions, the subsidiary was left with insufficient funds to compensate sufferers of asbestos-related conditions. But the report found the transactions did not amount to a breach of director's duties,[8] and that there was no legal obligation for James Hardie Industries Limited to provide greater funding to the subsidiary.[9] The directors would therefore be taken to have acted consistently with their duties to protect shareholders' interests. In March 2005, the chairwoman of James Hardie, Meredith Hellicar, publicly called for an extension of directors' duties under the *Corporations Act 2001* to protect decisions taking into account broader stakeholder interests.[10]

The decision to commence an inquiry into CSR and the *Corporations Act 2001* may be a reaction to complaints from company directors that the existing legal framework is too restrictive, and the perception that company directors, keen to make decisions that take into account broader social interests, are concerned that they are not permitted to do so, if they take a strict view of their directors' duties.

PILCH agrees that directors should be able to make 'socially responsible' decisions without fear of breaching their duties, but considers that a more prescriptive approach should be taken to directors' duties to actively encourage boards to take potential social and environmental impacts into account in their decision making.

### 4.2 How should directors' duties be defined?

If directors are to be required to take broader interests into account, how should the scope of those broader interests be defined, given the very large group of people who may potentially be affected by a company's business operations? PILCH considers that directors should be required to consider the effects of corporate decisions upon the community and the environment, to the extent that these are directly affected by a company's commercial operations. However, creating an obligation for boards in relation to considerations that companies must take into account may result in a process of 'box ticking' or 'lip service' to stakeholder interests becoming part of directors' routine decision-making. To encourage genuine engagement with CSR, directors' duties should not contain a fixed list of stakeholders to whom a duty is owed, but be designed to force directors to think about the outcomes of the company's operations and consider how these outcomes impact upon the company's broader social responsibilities.

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8 D F Jackson QC, *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation*, (21 September 2004) 15.

9 Ibid, 8.

10 Bill Phesant, 'Directors Need a Safe Harbour: Hellicar', *Australian Financial Review*, 17 March 2005, 3.

**The UK *Company Law Reform Bill 2005***

The UK Government currently proposes to amend directors' duties to enable what it calls an 'enlightened shareholder value' approach to decision-making.[11] The Company Law Reform Bill 2005 (UK) proposes to introduce a new statutory statement of directors' duties, which provides that directors' basic goal should be the success of the company for the benefit of shareholders, but that directors must take account, 'where relevant and so far as reasonably practicable', of:

(a) both the long and short term consequences of a decision; and

(b) any need of the company to have regard to the interests of its employees, to foster business relationships with suppliers, customers and others; to consider the impact of its operations upon the community and the environment and to maintain a reputation for high standards of business conduct.[12]

PILCH recommends that a new formulation of directors' duties be enacted, following the model used in the *Company Law Reform Bill 2005* (UK). That is, the formula should impose an obligation in general terms to consider impacts 'where relevant and so far as reasonably practicable' and state that directors are to take both a short and a long-term view of the interests of shareholders. The statutory formula could include a non-exhaustive list of interests that directors might consider. However, it is important that the list should not come to be viewed as a checklist of factors directors must demonstrate they have turned their minds to before proceeding with a course of action. For that reason, PILCH favours a formula couched in sufficiently general terms to encourage directors to genuinely consider and take account of the social and environmental impacts of company decisions.

Adopting the formula proposed in the United Kingdom would reduce some of the uncertainty relating to the new formulation of directors' duties by giving Australian company directors the benefit of both Australian and United Kingdom jurisprudence in informing their decision-making.

**Recommendation 3**

Parliament should enact a new s181A of the *Corporations Act 2001* as follows:

**181A Duty to consider non-member interests**

In exercising their powers and discharging their duties, directors or other officers of a corporation must, where relevant and so far as reasonably practicable, take account of:

(a) the likely consequences of any business judgement in both the long and short term;

11 Department of Trade and Industry, *Company Law Reform*, (March 2005) <www.dti.gov.uk/cld/review.htm>, 20.

12 *Company Law Reform Bill 2005* (UK), B3(3).

(b) any need of the corporation to take account of interests other than the interests of members, including the need:

(i) to have regard to the interests of its employees;

(ii) to foster its business relationships with suppliers, customers and others;

to consider the impact of its operations on the community and the environment; and

to maintain a reputation for high standards of business conduct.

Parliament should also enact the following amendment to s180(3):

After the words 'In this section' add 'and in section 181A'.

## 5. Corporate Codes of Conduct

### 5.1 Codes of conduct

Currently, companies listed on the Australian Stock Exchange ('**ASX**') are required to give some thought to considerations of environmental and social responsibility in order to comply with the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations ('**ASX Recommendations**').[13]

To comply with Principles 3 and 10 of the ASX Recommendations, companies must adopt a code of conduct setting out the company's view of its responsibilities to shareholders, clients, customers and consumers, employees, the community and individuals. The code of conduct should be backed up by a system ensuring compliance, and should enable employees to alert management to potential misconduct without fear of retribution.[14] The code of conduct, or a summary of its main provisions, is to be disclosed on the company's website.

The ASX Recommendations are not mandatory, in that the ASX Listing Rules provide that a listed company can either comply with the ASX Recommendations, or explain in its annual report the reason why it has chosen not to comply. Nevertheless, this 'comply or explain' model does require boards to consider CSR issues, even if only to explain why they do not consider them to be important. Further, the emphasis on disclosure of the company's position in relation to the ASX Recommendations enables scrutiny by investors, ratings agencies and analysts.

PILCH considers that the ASX Recommendations are a helpful guide for boards in identifying issues that companies should consider in their decision-making. However, the disclosure obligations imposed upon companies in relation to CSR should be strengthened and made referable to universal standards of measuring conduct. They should also be extended, so that they apply to non-listed companies.

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13 ASX, Listing Rule 4.10.3.

14 AXS, Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*. March 2003, 60.

### 5.2 International application of a code of conduct

**The *Corporate Code of Conduct Bill 2000***

In 2001, the Committee considered a Bill introduced by the Australian Democrats entitled the Corporate Code of Conduct Bill 2000. The Bill proposed to require companies with operations outside of Australia to:

(a) take reasonable measures to prevent environmental damage;

(b) comply with a number of basic workplace relation standards;

(c) refrain from certain types of discrimination in relation to employment;

(d) observe tax laws in their countries of operation; and

(e) protect consumer health and safety.

The Bill proposed requiring companies to provide a detailed annual report on their compliance with the code of conduct. The Bill would have made the code of conduct enforceable by ASIC, but would also have allowed persons who had suffered loss or damage from the activities of Australian companies overseas to seek injunctions or compensation in the Federal Court of Australia.[15]

The majority of the Committee recommended that the Bill not be passed, saying that it was 'unnecessary and unworkable'.[16] It stated that there was no demonstrated need for the Bill, and raised particular concerns in relation to what it saw as 'paternalistic' attempts to apply Australian standards to companies' overseas operations.[17]

As discussed above, PILCH considers that the general law of Australia is the proper place to prescribe the minimum standards companies should apply to their decision-making in relation to their Australian activities. Nevertheless there are a number of ways in which a code of conduct can be a valuable tool in taking a company beyond mere compliance.

(a) The requirement that a board consider establishing and disclosing a code of conduct causes boards to think about the values and ethical standards they want the company to uphold, and be seen to uphold.

(b) A code of conduct can express general principles that are to inform decision-making at all levels of a company's operations. For example, a code of conduct might include the principle that a company's decisions should be consistent not merely with the letter of the law but also with the spirit of the law.

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15 Parliamentary Joint Standing Committee on Corporations and Financial Services, *Report on the Corporate Code of Conduct Bill 2000* (June 2001), 4-6.

16 Ibid, 46.

17 Ibid, 45.

(a) A code of conduct can set higher minimum standards than those prescribed by law in Australia. For example, a code of conduct might provide for certain employee benefits or the company's participation in charity programs not required by law in Australia.

(b) A code of conduct might prescribe minimum standards for the conduct of the company's affairs in countries where the standards of conduct expected by the Australian community are either not reflected in local law, or are not enforced by local authorities. The code of conduct could provide that the code of conduct is not to apply to the extent of any direct inconsistency with local law (as opposed to merely setting a higher standard than local law).

PILCH does not agree with the argument that compliance with a code of conduct as well as with local laws would effectively require companies to comply with two sets of rules, which may not always be consistent.[18] Generally speaking, a code of conduct will comprise broad statements of principle, and will not prescribe standards of conduct with the same degree of specificity as government regulation. However, in the event that a code of conduct provides for a standard of conduct which is different to that required by the law of the place in which the company operates, the higher standard should be applied.

In practice it would be rare for a code of conduct to require a company to contravene a foreign law. However, it is a simple matter for the code of conduct to state that local law is to be complied with to the extent of any inconsistency.

**Recommendation 4**

The Committee should encourage companies to adopt codes of conduct containing statements of principle intended to govern the conduct of their affairs at all levels of decision-making. Companies' codes of conduct should apply equally to companies' Australian and overseas operations and should be backed up with appropriate internal compliance mechanisms.

## 5.3 Encouraging the adoption of codes of conduct

If companies are to be encouraged to adopt codes of conduct, how should this be effected? As we have seen above, currently, only companies listed on the ASX are required to adopt a code of conduct (or explain their reasons for not doing so).

### (a) Mandatory uniform code of conduct

The Committee has already considered and rejected a Bill for the introduction of a mandatory uniform code of conduct prescribing substantive standards governing companies' operations outside Australia.

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18 See, for example, the Business Council of Australia, cited in Parliamentary Joint Standing Committee on Corporations and Financial Services, *Report on the Corporate Code of Conduct Bill 2000* (June 2001), 13.

The possibility of adopting a mandatory uniform code of conduct for Australian companies deserves close consideration. The introduction of a mandatory uniform code of conduct could entrench a set of core minimum standards referable to an internationally accepted statement of human rights standards, such as the UN Human Rights Norms for Business. If Australia gave legislative force to an international set of standards, it may have the effect of giving momentum to movements to make companies abide by those standards elsewhere.

PILCH acknowledges, however, that the introduction of a uniform code of conduct containing environmental and social standards would be a circuitous way of imposing those standards of conduct upon companies. As stated above, PILCH considers that a more appropriate place for the expression of the standards to be expected of Australian corporations is the law of Australia.

Whilst PILCH considers that a uniform code of conduct for Australian companies operating overseas would have a beneficial effect in countries where the standards set out in the code of conduct are not reflected in local law, or are not enforced, PILCH is aware that the Committee has considered, and rejected, a bill for the introduction of a mandatory universal code of conduct applying to the overseas operations of Australian companies. In light of this fact, and the terms of reference of the present Inquiry, PILCH does not make any specific recommendation in relation to a mandatory code of conduct.

**(b) What regulatory mechanism?**

The mechanism by which companies are to be encouraged to adopt a code of conduct will be an important factor in creating a culture of corporate social responsibility among decision-makers. For a company's code of conduct to be meaningful, it must be a genuine and considered statement of the company's values and ethical standards. The Committee should therefore seek the regulatory mechanism most likely to encourage engagement with the process by directors.

PILCH considers that a simple legislative requirement that companies adopt a code of conduct may have the effect of producing a 'mere compliance' mindset amongst company decision-makers. A more effective way to encourage companies to adopt genuine, considered positions in relation to the social and environmental responsibilities would be to adopt a 'comply or explain' approach, coupled with comprehensive disclosure and reporting. The subject of disclosure is discussed in greater detail under heading 6 below.

**(c) Which companies should adopt codes of conduct?**

Presently the requirement that an ASX listed company disclose a code of conduct (or explain why it choses not to do so) is imposed by the ASX Listing Rules. There is no reason why the requirement should be limited to listed companies. All companies have the potential to produce social and

environmental effects as a consequence of their operations. However, many small companies lack the resources to attend to disclosure of their position in relation to social and environmental responsibility.

The requirement to adopt and disclose a code of conduct should be extended from all ASX listed companies to all public companies (as defined in s 9 of the *Corporations Act 2001*) and all large proprietary companies (as defined in s 45A(3) of the *Corporations Act 2001*). Companies which do not have the resources or the will to adopt a code of conduct can satisfy the requirement simply by explaining their reasons for not adopting or not disclosing their code of conduct.

By adding a provision relating to a disclosure of codes of conduct in Part 2M.3 of the *Corporations Act 2001*, Parliament could create a disclosure obligation sanctionable by the application of a civil penalty provision in appropriate circumstances.

**Recommendation 5**

Companies should be encouraged to adopt a code of conduct by the introduction of a requirement that they disclose publicly their code of conduct, or disclose publicly their reasons for not disclosing their code of conduct ('**comply or explain requirement**').

The comply or explain requirement should apply to all public companies and large proprietary companies, as those terms are defined in sections 9 and 45A(3) of the *Corporations Act 2001*.

The *Corporations Act 2001* should be amended by the insertion of a new Division 9 in Part 2M.3 as follows:

**Division 9 Code of Conduct**

**323DB Disclosure of a Code of Conduct**

(1) A public company or a large proprietary company must:

(a) adopt a code of conduct; and

(b) make the code of conduct publicly available.

(2) A public company or a large proprietary company need not comply with paragraph (1) if it publishes a statement of its reasons for not complying with paragraph (1).

(3) For the purposes of paragraphs (1) and (2), it is sufficient that a public company or a large proprietary company:

(a) makes its code of conduct, or a statement of reasons under paragraph (2), available for downloading from its website; or

(b) if the company cannot reasonably make its code of conduct available on its website, makes its code of conduct, or a statement of reasons under paragraph (2), available on request from its registered office.

### 5.4 The content of a code of conduct

The ASX Recommendations contain a useful list of issues that could be covered by a code of conduct.[19] PILCH endorses the content proposed by the ASX Recommendations for companies with operations within Australia.

However, PILCH views it as appropriate that the code of conduct be referable to international standards. The code of conduct should be required to make reference to the United Nations draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights.

**The UN Human Rights Norms for Business**

In 2003, the UN Sub-Commission on the Promotion and Protection of Human Rights adopted the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights ('**UN Norms**').[20] The UN Norms are a set of rules for business, derived from existing international treaties and standards, which apply to companies with operations in two or more countries.[21] The UN Norms deal with non-discrimination, protection of civilians and the laws of war, the use of security forces, workers' rights, corruption, consumer protection and human rights, economic, social and cultural rights, environmental protection and indigenous peoples' rights.[22]

The UN Norms are not binding on companies unless Governments legislate to implement them. During consultation in respect of the UN Norms, it was clear that the Australian Government did not support mandatory norms for business, and instead took the position that the responsibility for the implementation of international human rights standards rests primarily with States and not business.[23]

Further information: www.ohchr.org/english/issues/globalization/business/

19 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (March 2003) Box 10.1, p 60.

20 UN Doc E/CN.4/Sub/2/2003/38/Rev.2 (2003).

21 Their application extends to other business enterprises that have relations with transnational companies, or whose activities are not entirely local (Article 21).

22 Amnesty International, *The UN Human Rights Norms for Business: Towards Legal Accountability* (Amnesty International Publications, 2004).

23 Australian Permanent Mission to the UN, *Comments by Australia in respect of the report requested from the Office of the High Commission for Human Rights by the Commission on Human Rights in its decision 2004-116 of 20 April 2004 on existing initiatives and standards relating to the responsibility of transnational corporations and related business enterprises with regard to human rights* (8 September 2004).

**Recommendation 6**

Transnational companies should be encouraged to refer to and use the UN Norms as a model when drafting their codes of conduct.

Code of conduct should be defined in s9 of the *Corporations Act 2001* as follows:

> ***code of conduct*** means a document or documents stating the principles guiding decision making in the conduct of the affairs of the company. A code of conduct may include:
>
> (a) a statement of commitment to the code of conduct by the directors and officers of the company;
>
> (b) a statement of the company's view of its responsibilities to shareholders and the financial community;
>
> (c) a statement of the company's view of its responsibilities to clients, customers and consumers;
>
> (d) a statement of the company's employment and workplace relations practices;
>
> (e) a statement of the company's view of its obligations relative to fair trading and dealing;
>
> (f) a statement of the company's view of its responsibilities to the community and to the environment;
>
> (g) a statement of the company's view of its responsibilities to the individual;
>
> (h) a description of the company's systems for compliance with legal and regulatory obligations affecting its operations in Australia and overseas;
>
> (i) a description of the company's systems for compliance with the code of conduct; and
>
> (j) a summary of the differences between the standards of conduct in the code of conduct and the standards set in the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights published by the United Nations Sub-Commission on the Promotion and Protection of Human Rights.

## 6. CSR Reporting and Disclosure

### 6.1 Current disclosure requirements

Companies must make public disclosure in relation to a number of matters, both under the *Corporations Act 2001* and, if they are a listed company, under the ASX Listing Rules. Disclosure of this type is currently made in a company's annual report, on its website or in releases to the ASX under 'continuous disclosure' provisions.

Currently, matters of potential relevance to an assessment of the company's social responsibility are largely absent from the reporting requirements for a company's annual report, which is mostly concerned with the company's financial performance, shareholding and governance structure. Two possible exceptions are the

requirement that a company disclose likely developments in its operations in future financial years and details of its performance in relation to environmental regulation.[24]

Companies listed on the ASX are subject to an obligation of continuous disclosure. Broadly speaking, the company must immediately tell the ASX once it becomes aware of any information that a reasonable person would expect to have a material effect on the price or value of its shares.[25] In practice this has required companies to disclose a broad range of matters, including some matters which have a bearing on the company's social responsibilities.

The CSR performance of companies is increasingly the subject of scrutiny by CSR monitoring agencies. Key drivers of the trend of social responsibility monitoring appear to be an increasing recognition of the importance of sustainable business management in creating long-term value for shareholders, and increased investor awareness of the social and environmental impact connected with the use of their funds.

However, effective monitoring of companies' CSR performance depends upon the availability and reliability of the information used to assess that performance. Whilst the *Corporations Act 2001* and the ASX Recommendations require a limited amount of disclosure relevant to CSR to be made in a company's annual report and on its website, the disclosure requirements are not of universal application, and do not enable a comprehensive assessment of companies' CSR performance.

### 6.2 How could CSR disclosure be strengthened?

CSR reporting should be the principal means by which CSR is encouraged among Australian companies. The reporting and disclosure regime should be designed to promote transparency and timely disclosure of key events and to facilitate ready comparison of companies' CSR performance.

#### (a) Transparency

Whenever possible, companies should be required to make their policies in relation to dealings with stakeholders and the environment available on their websites.

Currently, companies are required to disclose their code of conduct and the charters governing the operation of their board and board committees, or a summary of the key provisions of these documents, by the ASX Recommendations.

These requirements could be substantially strengthened to require companies to companies to disclose information enabling third parties to conduct a more in-depth evaluation of a company's CSR performance. Companies should be required to disclose all polices relating to their dealing with stakeholders and the environment.

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[24] *Corporations Act 2001* (Cth) ss 299(1)(e), 299(1)(f).

[25] ASX, Listing Rule 3.1.

Relevant documents would include:

(i) human resources manuals and equivalent policies and procedures;

(ii) occupational health and safety manuals and policies;

(iii) environmental management systems documents;

(iv) privacy policies;

(v) debt collection and hardship policies;

(vi) ethical procurement policies; and

(vii) customer satisfaction and complaints handling and dispute resolution policies.

**(b) Timely disclosure of material events**

The obligation in the ASX Listing Rules that a Listed Company disclose events expected to have a material effect upon share price should be extended to apply to events having a material effect upon a company's CSR performance. In particular, companies should disclose events involving breaches of the company's code of conduct.

**(c) Enabling comparison of CSR performance**

Australian companies should be required to address a universal set of CSR criteria in their annual reporting, to enable investors and ratings agencies to easily compare their CSR performance with their peers. To the extent possible, the reporting should be made referable to international standards.

**Example: the Global Reporting Initiative**

The Global Reporting Initiative ('**GRI**') is an international organization that produces globally applicable Sustainability Reporting Guidelines ('**Guidelines**'). The Guidelines are intended to complement conventional financial reporting by requiring companies to report annually on economic, environmental and social impacts of their activities. Reporting under the Guidelines is voluntary. Australian listed companies that report under the Guidelines include Rio Tinto Limited, BHP Billiton Limited, Insurance Australia Group Limited and Westpac Banking Corporation Limited.

Further information: www.globalreporting.org

**Recommendation 7**

Public companies and large proprietary companies should be required to disclose all internal policies, manuals and other documents relating to their CSR performance on their website.

The *Corporations Act 2001* should be amended by the addition of a new section in the proposed Division 9 of Part 2M.3 as follows:

**s323DC Disclosure of Corporate Policies**

(1) A public company or a large proprietary company must make publicly available all policies, manuals and other statements of the company's practices that the company considers relevant to the discharge of its responsibilities pursuant to its code of conduct.

(2) A public company or a large proprietary company need not comply with paragraph (1) if it publishes a statement of its reasons for not complying with paragraph (1).

(3) For the purposes of paragraphs (1) and (2), it is sufficient that a public company or a large proprietary company:

(a) makes the documents referred to in paragraph (1), or a statement of reasons under paragraph (2), available for downloading from its website; or

(b) if the company cannot reasonably make the documents referred to in paragraph (1), or a statement of reasons under paragraph 2, available on its website, makes its code of conduct, or a statement of reasons under paragraph (2), available on request from its registered office.

**Recommendation 8**

In addition to existing continuous disclosure obligations, listed companies should be required to make immediate disclosure of events having a material effect on the company's CSR performance.

**Recommendation 9**

Public companies and large proprietary companies should be required to report, in their annual report, using the GRI Guidelines. The *Corporations Act 2001* should be amended by the insertion of a new paragraph in section 299 (which deals with the information to be set out in the Annual Directors' Report) as follows:

**299(4) Sustainability Reporting**

A public company or a large proprietary company must provide a report relating to sustainability and corporate social responsibility consistent with guidelines prescribed by the Minister.

The proposed section 299(4) above is designed to permit the Government to make regulations specifying the relevant GRI Guidelines under which companies' sustainability and social responsibility reporting is to be made.

## 7. Shareholders' CSR Expectations

### 7.1 Shareholder activism

Under the *Corporations Act 2001* a company's shareholders can requisition a general meeting, and can have a resolution put before that meeting, or another general meeting, if they control 5% of the votes that may be cast at a general meeting, or the request comes from 100 shareholders entitled to vote at a general meeting.[26] A meeting cannot be requisitioned in this way for the purposes of considering a resolution that is solely within the authority of directors.[27]

The 100 shareholder rule has come under scrutiny in recent years. As well as being used by environmental groups to place resolutions before company meetings, it has attracted negative attention after groups contesting NRMA board elections used it to force 12 extraordinary general meetings of the company over a 2 year period.[28] The Government attempted to remove the 100 shareholder rule for public companies by regulation in 2000, and by a bill amending the *Corporations Act 2001* in 2002. Both attempts were blocked by the Senate.[29]

Another way of gaining the attention of the general meeting of a listed company is to nominate as a director, although some company constitutions require a minimum shareholding in order to nominate.[30]

PILCH considers that it is appropriate and desirable for shareholders to have a mechanism by which to raise issues relating to the social and environmental responsibility of the company of which they are shareholders. A minority of shareholders does not currently have the power to requisition a meeting to discuss resolutions relating to social and environmental performance, nor should they have such a power. However, if Australian companies are to be encouraged to make socially responsible decisions, they should be required to acknowledge shareholders' concerns and account to shareholders in relation to the social and environmental performance.

**Recommendation 10**

The 5% or 100 shareholder rule in s249D of the *Corporations Act 2001* should be retained as a mechanism by which shareholders are able to place resolutions before general meetings relating to the company's social and environmental performance.

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26 Section 249D.

27 Ford, Austin & Ramsay, above note 9, [7.410].

28 Labor Council of NSW 'New Bid to Block Shareholder Pests' *Bosswatch*, 4 December 2004 <bosswatch.labor.net.au/news/general/1038974183_2686.php>

29 Ford, Austin & Ramsay, above note 9, [7.410]; Cosima Marriner & Anne Lampe, 'Shareholder Pest Clause Lacks Critical Votes' *Sydney Morning Herald*, 4 December 2002.

30 ASX Listing Rule 14.3 requires listed entities to accept nominations for directors up to 35 business days from the date of the meeting (or 30 business days in the case of meetings requisitioned by members). For a discussion of this approach, see Stephen Mayne, 'Corporate Law Reform Wishlist', *Crikey!* (10 November 2003) <www.crikey.com.au/articles/2003/11/10-0002.html>.

The Committee should consider other mechanisms by which companies can be made more responsive to the demands of shareholders in relation to social and environmental performance.

### 7.2 Empowering indirect shareholders

A significant feature of Australia's capital markets is the dominance of institutional investors such as superannuation funds, fund managers and other financial institutions. According to the ASX, in 2000, 38% of adult Australians held shares indirectly, including 13% whose only share ownership was indirect.[31] Although indirect investors' funds represent a significant proportion of the capital on the Australian market, indirect investors do not participate in corporate governance, because the votes attached to their shares are exercised by the managers of their funds.

How to enable indirect shareholders to participate in and influence the CSR values of the companies in which they indirectly invest, is an important issue for the Australian market. As a start, fund managers could be required to disclose the principles upon which they base investment decisions, having reference to CSR objectives. Already, fund managers are creating 'ethical investment' products, and sustainability indices allow investors to track the performance of sustainable investments. However, a challenge for the Australian market is to develop a meaningful disclosure framework enabling retail investors to easily distinguish fund managers on the basis of the CSR values informing the investments they make.

**Recommendation 11**

The Committee should consider ways in which large institutional shareholders such as superannuation funds and other financial institutions can inform retail investors of any ethical, social and environmental principles that will be used to make investment decisions. In doing so, the Committee should have regard to the need for such information to be presented in an accessible way to enable retail investors to readily compare funds' policies with one another.

## 8. CSR in Procurement of Goods and Services

In addition to making legislative amendments to encourage CSR in Australian companies, the Government could adopt policies to encourage CSR through its dealings with the private sector. The Government has significant dealings with companies through its procurement of a wide range of goods and services. By imposing a requirement that companies providing goods or services to government and government-owned business enterprises, a significant number of companies could be encouraged to review their CSR performance.

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31 ASX, *2000 Australian Shareownership Study* <www.asx.com.au/about/pdf/ShareownershipSurvey2000.pdf> 6. 'Indirect share ownership' for these purposes does not include shares owned by superannuation funds, other than non-compulsory, personally-managed superannuation funds.

**Example: the Victorian Government's Legal Services Contract**

The Victorian Government has an arrangement in place to encourage the thirty two law firms who make up its panel of legal services providers to engage in pro bono work. Panel firms commit themselves to providing free legal services of a value equivalent to a set percentage of the fees the firm generates as a result of work for the Government.[32] In the period from July 2002 to December 2003, panel firms provided pro bono legal services with a value of $2.6 million to the disadvantaged, for charitable organisations and public interest groups.[33]

**Recommendation 12**

The Commonwealth Government should introduce a policy of procuring only from companies whose CSR performance meets defined benchmarks.

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32 Department of Justice, *Policy Guidelines for the delivery of Pro Bono services for an Approved Cause under the Government Legal Services Contract*, at <www.justice.vic.gov.au/CA256902000FE154/Lookup/GLS_PDFs/$file/ProBonoPolicyGuidelinesAmended.pdf>.

33 Department of Justice, *Government Legal Services Report to the Attorney General* (1 July 2003 – 30 June 2004) at <www.justice.vic.gov.au/CA256902000FE154/Lookup/GLS_PDFs/$file/GovernmentLegalServices_20032004_Annual_Report.pdf>, 13.