30 September 2005

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

By email to corporations.joint@aph.gov.au

Dear Sir/Madam

Parliamentary Joint Committee Inquiry into Corporate Responsibility

Thank you for the opportunity to make a submission to the Inquiry. Our submission is enclosed for your attention. We would also welcome the opportunity to appear at the Committee's hearings and look forward to receiving confirmation of the date and time for those hearings.
Please do not hesitate to contact me on (02) 8248 6600, should you have any questions.
Yours faithfully

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Submission

to

Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Responsibility

30 September 2005

Executive Summary

The Australian Institute of Company Directors (AICD) is the principal professional body representing directors in Australia. Its members are directors of a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, and government and semi-government bodies.

AICD strongly endorses the concept of corporate responsibility.

However, legislation and regulation should only prescribe minimum standards of behaviour. AICD considers that those minimum standards have already been addressed. Further, the plethora of state and federal legislation is sufficient to permit (and often require) directors to take into account the interests of the broad range of stakeholders in managing a corporation. The *Corporations Act* does not hinder Australian companies or directors from taking into account the interests of all stakeholders in a way that is necessary to ensure that a company is successful and sustainable.

AICD also believes that there is no justification for imposing a generalised "social responsibility" obligation on Australian companies that is not also imposed on individuals and other forms of business enterprise.

More than most phrases, "corporate social responsibility" (CSR) means different things to different people. This threshold difficulty of a clear definition makes it inappropriate for mandated behaviour.

For the vast majority of Australian boards, determining the "interests of the company" as a sustainable entity is not a question of trade-offs between competing stakeholder interests. Australian boards generally operate on the basis that to be sustainable, a corporation must maintain a reputation for ethical conduct and accommodate the legitimate interests of shareholders, employees, customers, business partners, the communities affected by their operations and the environment. This approach is necessary to meet both changing societal expectations and the requirements of law.

This is evident from the annual reports, corporate responsibility statements and sustainability reports of leading companies that aspire to "best practice" in this area, as well as the many codes of conduct, environmental impact and community projects and charitable programs reported on the websites of many Australian listed companies. It is also clear from these materials that many Australian companies are intent on ensuring that these values are adopted at all levels of the organisation. The "ripple" effect can also be seen from the disclosure by a number of larger companies that they require those who participate in their supply chain to sign on to the social and environmental standards they have adopted as a pre-requisite to doing business.

The *Corporations Act* should not be amended to impose an additional generalised social responsibility obligation. If the Parliamentary Joint Committee for Corporations and Financial Services (PJC) nonetheless considers that legislation is required, it should only be permissive.

It would also be inappropriate to mandate further CSR based reporting obligations. There is already significant momentum in the development of sustainability reporting, both in Australia and internationally. The current diversity in this area reflects the "journey" that companies must take in developing sustainability standards and reporting methodologies suitable for their individual circumstances. It is clear that there is not a single model that would suit both large and small companies. AICD is also not convinced that there is any benefit to the Australian community in pre-empting the ongoing international debate in this area.

Introduction

All Australians operate in a social system of which legal obligation imposed by parliaments is only part. Ideally, laws should only deal with those things without which the society cannot operate safely, peacefully and in good order. This is the true essence of democracy – that apart from these things, citizens are free to pursue their own morality. As societal expectations of the conduct of its members change, citizens who fail to meet these expectations are generally not successful in the long term.

It is neither feasible nor desirable to look to the law to prescribe all of the matters necessary to engender good citizenship. This is as true of corporations as it is of individuals. AICD does not support the imposition by law of generalised "social responsibility" obligations on corporations (and their directors) which do not apply equally to individuals and other forms of enterprise.

In addressing the matters set out in the PJC's terms of reference published on 23 June 2005, the AICD hopes to demonstrate that:

- Australian companies must be able to act flexibly to meet changing societal expectations and the legitimate interests of "stakeholders". Existing law accommodates this.

- The vast body of existing state and federal law is sufficient to require corporations and their directors to meet the same standards of social responsibility as individuals and other forms of business enterprise without the need to impose a generalised obligation to do so under the *Corporations Act*. The areas in which legislative change could be useful are in supporting business judgements and permitting courts to authorise prospectively actions by directors.

- The overwhelming majority of Australian corporations operate as good citizens, acting well beyond their legal obligations because "enlightened self-interest" dictates that they do so to be sustainable in the long term: to manage reputation risk, to be profitable, to be able to hire suitably qualified staff, to identify and satisfy customer needs and to be welcome members of the communities affected by their activities. No further encouragement through legislation is required.

- The existing legal accountability of directors to shareholders is essential to promote good financial performance, and that accountability should not be diluted. Good financial performance is the best platform for meeting the expectations of stakeholders. Although some commentators perceive a tension between the interests of different stakeholders, while a company is a going concern that "tension" must be resolved and those interests accommodated if the corporation is to be reputable and sustainable in the long term. It is at the point of insolvency that stakeholder interests truly diverge, and there are existing mechanisms in the *Corporations Act* to deal with this.

- It is a mistake to look to the law for the whole answer. The vigilance of the media, the increasing activity of various investors, unions and other interest groups, the

existing legal and accounting framework and the disclosure practices adopted to meet the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (particularly Principles 3, 7 and 10) operate to make transparent Australian corporations' ethical standards and practices, without the need for parliament to impose further disclosure obligations. These mechanisms promote accountability of directors and companies in a timely and flexible way without encouraging greater recourse to law suits which would become problematical if a generalised "social responsibility" obligation were imposed.

Existing regard for stakeholder and community interest

Directors of Australian companies can already, and often must at law, take into account a wide range of interests in performing their duties to the company and its shareholders.

In forming corporate strategies, modern directors in fact take account of these diverse interests. Not only do they do this to satisfy any relevant minimum legal requirements, but also because they are acutely aware that if a company is to be reputable and sustainable, it must be able to demonstrate that the social, environmental and economic expectations which stakeholders legitimately have of the company are taken into account. Directors are also aware that these expectations shift over time, and that, in general, expectations – economic, social and legal – only increase.

Laws which apply generally

There is a large range of legislation which applies with the same force to corporations as it does to individuals. This legislation prescribes minimum standards which any person must observe. To name but a few examples of such legislation (often replicated at both state and federal level):

- environmental,
- financial services,
- human rights, equal opportunity, sex and racial discrimination,
- industrial relations,
- native title,
- occupational health and safety,
- taxation, and
- trade practices and fair trading.

Much of this legislation requires directors and other officers to take account of interests other than shareholders, often in preference to shareholders.

Existing corporate law

While there are many theories of "the corporation"[1], the courts have long recognised that directors put a company's survival at risk if they solely pursue profits and fail to take into account the impact of their decisions on a wide range of stakeholders. As long ago as 1883, in considering the powers of a company and the proper exercise of directors' duties under corporate law, the English Court of Chancery affirmed that:

> "…. you cannot say the company has only got power to spend money which it is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company given to them [by Companies Act] are always to be limited to the strictest possible view of what the obligations of the company are. …. Most businesses require liberal dealings. The test there again is not whether it is *bona fide* but whether, as well as being done *bona fide*, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carry on of the company's business for the company's benefit. ….. a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond would soon find itself deserted – at all events unless labour was very much more easy to obtain in the market than it often is."[2]

Today, the general duties of directors at common law are codified in sections 180-184 of the *Corporations Act*. These duties permit directors wide discretion in their actions, but they do require directors to act with care and diligence, in good faith and through the focus of the interests of the company, acting for the benefit of the company and for the purpose for which a power was conferred, and not to secure an advantage to themselves or others. The AICD considers this to be the proper focus for Australian companies and that it is flexible enough, taken with the general capacity of Australian companies to do anything which a natural person may do under section 124 of the Act [3], to accommodate the legitimate interests of all stakeholders.

There are a range of other provisions of the *Corporations Act* which require directors to take account of specific other interests: for instance, at the time of fundraising and takeovers and at times of uncertain corporate solvency.

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[1] See paragraphs 1,380-1,400 and 7,610-7630 of *Ford's Principles of Corporate Law* (12th Edition, 2005) by Professor HAJ Ford, The Hon. Justice RP Austin and Professor IM Ramsay for a useful discussion of these theories and a concise bibliography of relevant academic discussion.

[2] See *Hutton v West Cork Railway Co* (1883) 23 Ch D at pp 672-3 per Bowen LJ. This case is notable for the line: "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company".

[3] Corporate capacity can be limited by provisions in a company's constitution, but such limitations are rare in commercial enterprises. They are more generally found in the constitutions of companies limited by guarantee for the purpose of ensuring that the company's funds are used for specific charitable purposes and in order to satisfy the requirements of taxation authorities for eligibility for treatment as "charitable" institutions.

Existing practices

The corporate governance practices disclosed by Australian companies in response to the ASX Corporate Governance Council's Recommendations demonstrate the following:

- The overwhelming majority of the S&P Top 200 companies[4] have codes of conduct which recognise that to act in the best interest of the company, they must take into account the interests of other stakeholders, including employees, customers, the environment and communities affected by the company's activities.

- Many companies have separate "corporate social responsibility reports" or "sustainability reports", which cover extensively the performance of the company in social, environmental and governance areas[5]. These reports often reflect on conduct over successive periods. They have the impact of reinforcing the values expressed in the codes of conduct by demonstrating both to the community and the employees of the organisation that they abide by those codes. There are some companies which do not currently provide reports which have indicated that they are considering when and how to implement such reporting against growing community expectation[6]. There has been a growth of a range of plans which support charitable donations by companies and their employees. Some are "matching" plans under which companies match charitable donations made by employees. Other plans allow employees paid leave to pursue charitable projects.

- Many have community support programs: for instance financial literacy programs, schemes for the support of indigenous communities, regional projects supporting

[4] Representing at least 90% of the market capitalisation of the ASX. Source: review conducted by national law firm Freehills in September 2005.

[5] Examples (primarily derived from S&P/ASX 100) include: ANZ (www.anz.com.au); AGL (www.anz.com.au); BHP Billiton (www.bhpbilliton.com); Bluescope Steel (www.bluescopesteel.com); Boral (www.boral.com); Brambles (www.brambles.com); Santos (www.santos.com.au); National Australia Bank (www.nabgroup.com); Newcrest Mining (www.newcrest.com.au); Origin Energy (www.originenergy.com.au); Oxiana (www.oxiana.com.au); Paperlinx (www.paperlinx.com); Rio Tinto (www.riotinto.com); Telstra (www.telstra.com.au); Transfield Services (www.transfieldservices.com.au); Wesfarmers (www.wesfarmers.com.au); Westpac (www.westpac.com.au). Many of these are based on reporting structures such as the Global Reporting Initiative, but some are not. Other companies (not listed above) have sustainability policies against which they have some reporting, without a formal sustainability report.

[6] An example is Amcor, which says on its website:" Community expectations have changed. Amcor recognises that a 'meeting compliance' approach does not satisfy the expectations of stakeholders and we are conscious of the need to increase our public reporting of environmental and social issues. It is also critical that as a company we understand how we are progressing along the sustainability journey. In determining what aspects of sustainability to concentrate upon Amcor is working with its stakeholders. We recognise that our objectives will develop over time with increased dialogue and understanding between stakeholders.

Amcor's commitment to sustainability is supported by policies, objectives and targets, management procedures, continuing research and regular reporting and auditing. More specific information relating to Amcor's environmental and social ethics, which form an integral part of our overall sustainability can be found in dedicated sections of this website. Another lynchpin of our attitude to this vital part of who we are is embodied in our Mission Vision and Values - which is at the core of everything we do".

Landcare Australia and the Royal Flying Doctor, support for the Salvation Army (and similar charities dealing with poverty and homelessness), HIV Aids support, hands on learning with youth, provision of school resource information, support for medical research and development, support for local sporting teams. This sort of listing does not do justice to the range and depth of many of these programs.

It is a notable feature of the charitable and community support programs that most are related to the core business of the company, where the company is best positioned to see the need and serve it (eg financial literacy programs, regional land care, indigenous community programs) and where their operations are relevant to a local community. Some companies seek community partnerships, where their employees can participate by volunteering and have input to the development of the partnership. Corporations are sometimes criticised for failing to be sufficiently "philanthropic" – making charitable donations because doing so benefits the corporation by helping to attract staff or promoting the welfare of the communities in which they do business, not because they are a genuinely disinterested "good" people. However, AICD considers that the linkage is appropriate, as well as being supported by the requirements of existing law.

There is a range of contributing factors to these developments which may include:

- increased investor and press scrutiny of how companies act in relation to social, environmental and governance matters facilitated by the developments such as the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations and similar codes[7],

- the increased sensitivity of share price to illegal or socially unacceptable practices. A number of the recent corporate collapses have been characterised by revelations of bad practice where the corporation's "brand" has been so fatally affected that business became unviable (eg Arthur Andersen), or where the threat to the "brand" has caused new practices to be adopted (eg clothing and sporting companies whose exploitative use of third world labour has resulted in customer boycotts),

- the need to be able to attract qualified staff, who are sensitive to the "ethos" and reputation of an organisation in a global market, and

- the pressure of special interest groups expressed through participation in shareholder meetings, active press and internet campaigns and class actions.

There is a general correlation between the sophistication and extent of the development of codes, sustainability reports and charitable and community support programs and market capitalisation[8]. This is to be expected because it generally reflects both the funds available to the companies and the greater impact that the bigger companies have on the communities in

[7] Eg the UK Combined Code, the amendments to the NYSE rules and enforcement of investor standards publicised in the so called Investment & Financial Services Association "Blue Book".

[8] It is observable that many of the companies that are listed overseas (particularly the UK) may also be further along the path in "sustainability" reporting. While size and industry no doubt play their part, this may also be because they have had longer exposure to the "if not, why not" reporting of the Combined Code – and the advent of the ASX Corporate Governance Council's Principles and Recommendations may result in greater uptake of this practice over time in Australia.

which they operate as well as the practicalities of communicating and maintaining corporate culture in large organisations.

No legislative revision required for stakeholder interest to be taken into account

The AICD strongly recommends that the *Corporations Act* not be amended to require directors to take into account the interests of specific classes of stakeholders or the broader community when taking their decisions. AICD believes that the introduction of a generalised duty cannot be justified for the following reasons:

Directors need a way to prioritise among competing interests and a basis for accountability

Imposing a generalised CSR obligation on companies, especially through the mechanism of a change to directors' duties, will unsettle the fundamental "compass" of directors – the fact that they are stewards of other people's money and owe fiduciary duties to the company as a whole. That may have a range of consequences which are unpalatable and undesirable from a policy perspective.

The terminology in the CSR debate is inherently vague. Terms like "stakeholder", "community" and even "social responsibility" mean different things to different people, and at different stages of the social development of the broader community. These terms suggest that anyone identifiable as a "stakeholder" or a member of a "community" as such has an interest equally worthy of protection at all times. The AICD does not accept that this is the case.

As a practical matter, a generalised duty would be difficult to formulate – which "stakeholders" should be chosen? This intimately affects accountability.

- If the law is changed so that directors owe a duty to "stakeholders", it may perversely mean that directors and corporate management become less accountable because their duty is too generalised and they obtain too wide a discretion in how they expend corporate funds. It would make it harder for shareholders and regulators to call directors to account for poor performance because having too many masters dilutes accountability.

- If the law is changed so that directors owe a duty to named stakeholders (in addition to shareholders), it will necessarily leave out some which the current law is flexible enough to accommodate[9].

[9] Charitable and political donations become particularly difficult here. Under current law, the requirement to demonstrate corporate benefit tends to govern the extent and nature of the giving. If charities and political parties are not included as "stakeholders", this form of giving may be jeopardised entirely. If they are included – unless there are other provisions governing such dealings – the floodgates would be opened. It is notable that in the UK, there is a proposal to regulate political donations without shareholder approval (See part N of the exposure draft clauses)

The AICD considers that the balance created by the current law is more appropriate.

- As the *Corporations Act* is currently drafted, the focus of directors' accountability while the company is solvent is its shareholders, with the cases in which that obligation is to be overridden set out in other specific legislation.

  - As indicated previously, while the company is solvent, directors can take into account the interests of other stakeholders in performing their duties. For instance, charitable or political donations relevant to the company's business are permissible.

  - The interests of other stakeholders are supported as well by provisions such as section 1324 of the *Corporations Act* which allows a person whose interests have been or would be affected by a corporate activity in contravention of the *Corporations Act* to seek an injunction to prevent an action or require an action to be carried out or damages in appropriate cases.

  - At different stages of the company's life cycle – for instance – where solvency becomes doubtful, other interests come into focus and change entirely once the company goes into external administration (where the board's role may be supplanted entirely). Because the business is no longer sustainable, the interests of stakeholders other than creditors recede almost entirely – for instance, charitable giving would no longer be permissible.

- There is already a plethora of specific laws which mandate director's conduct in specific areas of activity. As a matter of policy, it is preferable that the occasions on which shareholder interests are to be overridden should be the subject of narrow, case by case legislation, rather than under a general requirement under the *Corporations Act*. Such specific laws provide clear guidance for directors about what is expected of them, and insulates the directors against claims by shareholders for failure to guard their interests properly.

- If a generalised duty to "stakeholders" is included in the *Corporations Act*, it would greatly expand the jurisdiction of the Australian Securities and Investments Commission (ASIC), in a way which is not desirable. ASIC is a disclosure and markets regulator: that is its expertise. If the obligation to "stakeholders" is expanded, then ASIC would have to deal with a much broader class of complaint and complainant. That would unduly tax its resources and expertise, and give rise to a great deal of duplication between its duties and those of other regulators.

It may impact investor confidence and the efficacy of companies as a collective investment vehicle

Corporations are an efficient vehicle for the collection and centralised investment of savings. It is bad public policy to shake the confidence of investors that their invested funds will be used other than primarily for their benefit, especially in an environment where compulsory

superannuation contributions direct funds into equity markets. It could disadvantage Australian companies as a destination for international funds and thereby impact employment opportunities by prejudicing the capacity to amass investment funds necessary for enterprise building and job creation in Australia.

It may affect Australia as a destination for incorporation

A generalised "social responsibility" obligation imposed under the *Corporations Act* is likely to apply only to Australian companies, and that may drive incorporation outside this jurisdiction and thus lessen Australian regulatory control. While Australia needs to maintain a reputation for a modern regulatory system, it should not be a market leader in the imposition of such duties in this area.

No justification for applying corporate social responsibility obligations to companies and not other entities or individuals

There is no justification for applying a generalised CSR duty on directors or corporations which does not apply to individuals and other forms of business enterprise.

It is flawed and overly simplistic to think of companies as "rich people" who can afford philanthropy[10]. Companies already pay taxes and contribute to the society by employment and the provision of goods and services and they represent the retirement savings of many Australians.

In any event, not all companies are substantial – the top 200 ASX listed companies account for over 90% of the market capitalisation. There are a further 1,300 listed companies, and many of them cannot afford to comply with all of the recommendations made by the ASX Corporate Governance Council. Apart from listed companies, there are hundreds of thousands of other Australian companies of all types, only some of which might be described as substantial. Yet many of these companies are important for the development of new ideas and industries and they are collectively significant employers (but without substantial discretionary resources).

Clarification

The AICD considers that the *Corporations Act* does not need to be amended to clarify (by amendment to those sections which deal with directors' duties) the extent to which directors may take into account the interests of stakeholders or the broader community when making their decisions.

If, however, the PJC decides that clarification is useful, AICD suggests that the PJC should take the following matters into account in making its recommendation:

[10] See the article in *The Age* on 11 August 2005 by Professor Mirko Bagaric and James McConville entitled "Social dividend the way for the super prosperous" – suggesting a compulsory charitable donation for companies who are very profitable.

- There should be a specific statement that any clarification is intended to be without prejudice to anything which directors could at law do prior to the amendment. Otherwise, the inclusion of some cases (eg employees and customers) may raise questions about whether other cases (eg the environment or suppliers or the communities affected by the company's operations) are now excluded by their omission.

- There should be a specific statement that any clarification does not amount to a requirement and does not confer on stakeholders a greater right to sue the company or directors than any of them might have had before the clarification was made.

- It is best to avoid words like "stakeholder" and lists of particular stakeholders. There are a number of states in the United States which have included in their laws permissions for directors to take into account the interests of named classes of stakeholders. The UK[11] is similarly considering such a clarification. However:

  - The formulations are all different, so there is no standard formulation.

  - In the United States, the "clarifications" overwhelmingly relate to conduct in takeovers, not to the general duty of directors. Notably, Delaware (the jurisdiction of preference for incorporation of most US listed companies) has no such provisions.

  - The formulations are generally relatively limited: employees, customers, suppliers, and sometimes the environment, and sometimes the communities affected by the company's activities.

  - All of the formulations operate in relation to the "company" and not the group of which the company forms part. [12]

What would be the best clarification?

If the PJC opts for clarification of directors' duties, AICD suggests the word 'best' be removed from section 181(1)(a) *Corporations Act*. Section 181(1)(a) would then read:

"181(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the interests of the corporation; and

(b) for a proper purpose."

[11] Item B(3) of the UK Company Law Reform Bill introduced in May 2005 which followed from the UK White Paper on Modernising Company Law is available on the UK Department of Trade and Industry website at www.dti.gov.uk.

[12] By way of interest, if any of the CSR debate is generated by the issues surrounding James Hardie, this formulation would not have helped, first because James Hardie is no longer an Australian company – so it is unaffected by any amendment to the *Corporations Act*. Second, the issue related to liabilities to former employees and users of products manufactured by subsidiaries of James Hardie, not James Hardie itself.

The reason for suggesting this change is that it would enable directors to consider a wider scope of alternatives and interests in making their decisions. It would take away any argument that the directors were not acting properly in the "best" interest of a corporation when they did so. It would also assist directors by removing the "hindsight" element inherent in judicial review of directors' decisions – societal understandings of what may be "best" can change between the time at which directors act, and the time a court may come to review them. This language is also more in line with the common law understanding of the duty.

AICD also recommends that the business judgement rule in section 180(2) of the *Corporations Act* be extended. If directors are increasingly called upon to have regard to a broad range of interests, they should also be given an appropriate 'shield' for doing so. When the Government introduced the business judgement rule as a defence to section 180, the Treasurer said that if the rule was a success, the Government would consider extending its application. AICD recommends extending the business judgement rule to sections 181-184, (but especially to section 181(1)), because this would support directors in taking a broader perspective in making their decisions in the interests of company, whilst maintaining the appropriate controls.

Are there other amendments to the *Corporations Act* required?

Give the court power to approve future actions of directors – expand section 1318(2)

Section 1318

Section 1318 allows a court wholly or partly to relieve a director from civil liability for negligence, default, breach of trust or breach of a specific directors' duty if the court decides that the director has acted honestly and that, in the circumstances, the director deserves to be excused. Section 1318(2) allows relief to be granted when a director "apprehends" that a claim will be made against him or her for, among other things, negligence or breach of duty.

The James Hardie case, through the decision of the NSW Court of Appeal in *Edwards*, has focussed attention on the shortcoming of section 1318(2) of the *Corporations Act*. The court found that section 1318(2) only gives the court jurisdiction to protect directors in respect of past conduct and not future actions, even when the future actions are the same as the past conduct sought to be relieved.

It is noteworthy that while all other corporate administrators[13] have various rights to approach the court for advice or directions about future conduct under the *Corporations Act*, and trustees have some rights under trustee legislation of the various States, directors alone lack this facility. Attached in the Schedule to this submission is some brief background in relation to the *Edwards* case which demonstrates the difficulty faced by directors and the courts once a company is in a position of doubtful solvency.

[13] See section 424 for controllers (which includes receivers), s467D for administrators and sections 479(3) and 511 for liquidators, including provisional liquidators by section 472.

AICD suggests that section 1318(2) should be amended to permit a court to provide prospective relief to directors from the consequences of well defined decisions, where the safeguards described in the Schedule to this submission have been met.

Are there any voluntary measures by which Australian companies could be encouraged to adopt socially and environmentally responsible business practices?

It is appropriate first to point out that the vast majority of Australian companies do act in a socially and environmentally responsible way, for all of the reasons previously mentioned. Having said that, AICD considers that there are some examples of appropriate ways for Government to support worthwhile industry-based initiatives.

The introduction of the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations – based on "if not, why not" disclosure - has encouraged many companies to adopt codes and practices which are relevant. Because these recommendations are not prescriptive, they have allowed companies to respond innovatively and given companies necessary flexibility to take into account issues such as the purpose for which they were created, their stage of development and the resources available to them.

AICD is aware that there have been a number of specific industry-based initiatives – such as the Commonwealth Government's Consumer and Financial Literacy Challenge. AICD supports this type of initiative which can be developed in consultation with industry groups, promoting well targeted use of socially relevant programs by companies with specific expertise.

AICD suggests that it is appropriate for the Government to lend its support to initiatives such as Computershare's E Tree, which promotes electronic communications between companies and their shareholders, limiting the need for paper communications. AICD notes that the CLERP 9 electronic communications legislation helped to facilitate this initiative. AICD considers that such facilitative legislation – rather than prescription – rewards and promotes innovation in ways that contribute to the sustainable development of the whole community.

Current reporting requirements associated with these issues are appropriate

Australian companies are currently subject to reporting requirements under a number of specific statutes, for example, occupational health and safety and environmental legislation. There is however, no current legislation requiring companies to report on CSR issues. AICD would be strongly opposed to mandating any form of CSR reporting.

One of the primary reasons for AICD's opposition to any mandatory reporting is that there are threshold definitional issues surrounding the subjects of CSR and 'triple bottom line'. As previously mentioned, the phrases mean different things to different people. This definitional confusion is not unique to Australia – views on what constitutes CSR differ internationally. The question "what does CSR mean" would elicit very different responses from a European, who looks to a broad range of stakeholders on one hand, and an American, who takes a far more black letter view, on the other hand.

These differing views are the result of cultural, structural and social differences. AICD believes that the debate surrounding these threshold definitional issues is still under way and that for Australia to move to mandatory legislation before the debate is fully developed would be premature. For example, when the phrase 'triple bottom line' was given wide publicity by Elkington in the 1990's it was readily adopted as useful shorthand for considering issues that were not purely financial or tangible. Ten years on, the phrase 'triple bottom line' is probably too limited to describe the sorts of subjects many would consider are encompassed by the phrase 'corporate social responsibility'. Change in this area is rapid.

The increasing rate of change in this area is a further argument against imposing any form of mandatory CSR requirements. For a good illustration of the rate of change in this area see two of the major findings of the recent KPMG International Survey[14]:

- Corporate responsibility reporting has been steadily rising since 1993 and it has increased substantially in the past three years.

- A dramatic change has been the type of corporate responsibility reporting: changed from the purely environmental reporting up until 1999 to sustainability (social, environmental and economic) reporting which has now become mainstream among G250 [Top 250 companies of the Fortune 500] companies (68 per cent) and fast becoming so among N100 [Top 100 companies in 16 countries] companies (48 per cent).

If Australia were to move to mandatory reporting on CSR there is the potential for it to be caught between the more inclusive European view and the more prescriptive American view. AICD believes that neither of these approaches is suitable for Australia's particular circumstances. The difficulty of wholesale adoption of overseas approaches in Australia before the position is settled internationally has been best illustrated recently by the Australian move to international accounting standards. Australian companies have been grappling with moving to international standards some of which are proving to be unsuited to Australian conditions. AICD cautions against moving to prescription in an area that it still developing and which is changing rapidly.

The absence of any mandatory Australian CSR reporting requirements does not mean that Australian companies are not actively engaged in considering CSR issues and reporting on them. The Top 100 Australian companies were considered by the KPMG international survey[15]. A number of these leading Australian companies have adopted and continue to refine highly innovative and sophisticated approaches to this type of reporting without any form of prescription. Reports from companies in the insurance, mining and banking sectors are good examples of this type of reporting. These companies see CSR as fundamental to their business sustainability. For these companies, CSR is about good business practices; they see good reporting on CSR as being the way they do business and as giving them an advantage over their competitors.

[14] 'KPMG International Survey of Corporate Responsibility Reporting 2005', KPMG Global Sustainability Services, Amsterdam, 2005 at page 4

[15] KPMG Survey at page 38

Companies that are innovators in this area are also responding to the increased interest in recent years of a broad range of investors in their approach to CSR. More Australians than ever before own shares either directly as a result of demutualisations or indirectly through their superannuation contributions to the large funds. AICD believes that as the pool of retirement savings grows investors' interest in CSR will continue to grow without any legislative intervention.

The other difficulty with moving to any form of mandatory reporting in this area is that how a company approaches the issue of CSR is necessarily highly individual. The issues facing a multinational mining company dealing with a range of local communities, a telecommunications company with significant operations in rural and regional Australia and a small listed information technology company are very different. Any regulation that might suit the needs of these companies would be either too high level or imprecise to encompass all the differences and therefore unenforceable, or so sector specific that it would be too complex and prescriptive. Clearly no one model suits the needs of all of these different types of companies. AICD members involved in CSR issues report that each company addresses these issues differently at different stages in their development and that different approaches suit companies at particular stages.

There are reporting frameworks in existence such as the Global Reporting Initiative (GRI) which is widely used by a number of large companies internationally and by a number of the larger Australian companies. AICD would not support mandating adoption of the GRI in Australia nor in any other framework. AICD believes that reporting on CSR in Australia is at a very early stage and mandating any particular approach is likely to stifle innovation and experimentation by companies and to lead to a mentality where directors and management focus on compliance only. The United Kingdom has recently introduced a requirement for listed companies to produce an 'Operating and Financial Review' (OFR). AICD believes the Australian 'Management Discussion and Analysis' is a good approximation for the OFR and does not see a need for introducing the OFR into Australia.

AICD would also argue that, at least for listed companies, which take their CSR responsibilities seriously, the issue is already covered by ASX Principles 3, 7 and 10 where companies report on their promotion of ethical and responsible decision making, their recognition and management of risk and their recognition of their legal and other obligations to their legitimate stakeholders. Although the ASX Principles only apply to listed companies a number of AICD members report that supply chain relationships are moving smaller companies towards a broader recognition of CSR issues. This trend is likely to continue. The other development in this area is the Standards Australia Corporate Governance Guidelines which have been widely adopted voluntarily by listed, unlisted, public and private sector bodies in Australia.

While AICD opposes any form of mandatory CSR reporting; the existing market driven disclosure of companies' CSR practices is more easily tailored to the individual profile of companies and the emerging expectations of investors and other users of the reports. If the PJC considers that increased CSR is needed, AICD would be prepared to consider some additional guidance around ASX Corporate Governance Council Principle 3, which is developed by industry and which sits outside the Principles. The incorporations by reference to the G100 publications: 'Guide to Review of Operations and Financial Condition' and 'Guide to Compliance with Principle 7 in the ASX Principles are good models. AICD suggests that the best method of achieving meaningful disclosure of companies' CSR

activities is to avoid mandatory 'one size fits all' reporting. The flexibility of the ASX Principles' 'if not, why not approach' is preferable and achieves the goal of enhanced disclosure without stifling flexibility or innovation.

Conclusion

AICD welcomes the opportunity to make this submission to the PJC and would be pleased to address any questions you have either in person or by further submission.

SCHEDULE

Edwards case

In *Edwards*, an application was made by the directors of Medical Research and Compensation Foundation, a company limited by guarantee (Foundation), established to act as trustee of the fund created by James Hardie to compensate people with asbestos related disease as a result of exposure to James Hardie asbestos products. The application was also made by them as directors of Amaba and Amaca, the former James Hardie subsidiaries (now owned by the Foundation as a result of 2001 scheme of arrangement) which had conducted the James Hardie asbestos operations.

The particular difficulties faced by the directors and the court were:

- If the directors paid all current claims made by those with asbestos related diseases (for which there were sufficient funds both now and for the immediate future), the pool of funds available to future claimants (who were not currently identified, because they had not yet fallen ill, but were almost certain to exist in the next 40 years) would be exhausted before all possible claims were dealt with.

- However, if the directors appointed a provisional liquidator, then substantial funds would be expended in the provisional liquidator coming up to speed on relevant issues, and more importantly, the payment of agreed claims would be compromised both as to timing and amount. As the court pointed out, the lifespan of someone with an asbestos related disease is generally not long after diagnosis, and this meant that many who suffered from the disease whose claims had been processed would not have the comfort before their death of knowing that their family had been provided for.

- The appointment of a liquidator would have the effect of barring the very future creditors whose claims theoretically meant that the fund was insufficient. This is because future identified creditors claims could not be made in the liquidation because they were not "creditors" at the time of the liquidation (see below in relation to "who is a creditor"). Therefore even though there was a real possibility that the Foundation might be given access to further funds arising out of the negotiations between James Hardie and the unions, if the liquidation had started they may not assist the future identified claimants.

- The directors were concerned that, even though they were acting honestly and trying to do their best by those likely to be affected by asbestos disease, they could be personally liable and guilty of insolvent trading (or failure to preserve the assets of the fund) if they continued to make payments while this issue was uncertain[16]. They were unable to obtain insurance. There was no point in appointing a receiver, since the receiver also could not get insurance.

[16] Their application to the court was in June 2004.

The way forward

AICD considers that, as demonstrated in the *Edwards* case, where directors are acting honestly and the scope of the proposal is well defined, there is a good case for such an amendment to section 1318(2) to permit the court to authorise directors' actions prospectively. This is especially so where – as here – the directors were unable to obtain insurance. To quote Young CJ:

> "154 Whilst it is important to ensure that people do not misuse the corporate veil and the principle of limited liability and trade whilst insolvent, it is also necessary to see to it that where companies are in a precarious position they are managed by people with the appropriate business expertise. One consequence of the trading whilst insolvent provisions is that such expertise is not available to companies because of the justified fear that personal liability might attach or even that there will be an attempt by a creditor to say that personal liability attached which can only be tested in an expensive set of proceedings.
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> 155 The solution latterly suggested by Mr Jackman (counsel for one of the parties) of receivership is, with respect, just another manifestation of the way in which the *Corporations Act* compels companies in a precarious financial position to spend mega dollars on accountants to endeavour to salvage their position instead merely of appointing more experienced directors to the board. However, as the law at the moment does not permit a court to announce absolution in advance it will only be in rare cases that the Court can do anything about the matter".

The court has previously noted that directors stand alone among corporate administrators in their inability to seek directions in relation to future conduct[17]. The court therefore has wide experience in providing assistance of this kind.

AICD suggests that a proposal might encompass the following features:

- The court would be given an expanded jurisdiction under section 1318(2) to give advice to directors and to authorise prospective action which might otherwise give rise to liability for negligence, breach of trust or breach of duty (including insolvent trading).

- Recognising that courts are often uncomfortable with making orders which can affect the rights of people not represented before it unless they have been given an opportunity to be heard:

  - an application to the court might require advertisement so that shareholders or affected creditors can object;

  - the court should be empowered to appoint a "contradictor" which could assist the court in ensuring that all relevant issues are raised.

[17] See para 28 of *Edwards Case*

- The court would need to act on a defined proposal and it would be the job of the directors to formulate it and to attest to its commercial desirability, pointing out to the court, to the extent that they are aware, the way in which the proposal might affect the interests of shareholders and creditors, as well as any personal interest they might have. The court should have discretion to limit the implementation of any proposal to a particular time frame or dollar amount or dealings with specified persons. That should be left to the discretion of the court, but the court should be given express power to extend the timeframe or scope of a proposal for which it has previously granted an order.

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