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Making Corporate Social Responsibility an Everyday Part of the Business of Business: Offering Realistic Options for Regulatory Reform

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Making Corporate Social Responsibility an Everyday Part of the Business of Business: Offering Realistic Options for Regulatory Reform

Abstract

As corporations have become powerful and ubiquitous there has been a growing interest in what ethical and social responsibility they have towards the community. Such responsibility is not limited to philanthropic donations but broadly refers to the interests of stakeholders, all of whom contribute to and are affected by the success or failure of a business. Company stakeholders include shareholders, employees, creditors, customers and, depending on the industry and its impact upon its surrounding social and natural environment, the government and the greater community. This paper will argue that there are strong commercial and moral imperatives which indicate that a corporation should as 'part of the business of business' act in an ethical and socially responsible way. Examples of corporate misconduct will illustrate that there are instances where a company's social responsibilities should take precedence over the goal of profit maximization. It will be posited however, that in most circumstances these goals are complementary rather than antithetical to each other. Finally, a number of reforms will be considered and suggestions made about their utility to Australian businesses.

Keywords

Corporate social responsibility, regulatory reform, ethical responsibility

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

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Introduction

As corporations have become powerful and ubiquitous there has been a growing interest in what ethical and social responsibility they have towards the community. Such responsibility is not limited to philanthropic donations but broadly refers to the interests of stakeholders, all of whom contribute to and are affected by the success or failure of a business.¹ Company stakeholders include shareholders, employees, creditors, customers and, depending on the industry and its impact upon its surrounding social and natural environment, the government and the greater community.² This paper will argue that there are strong commercial and moral imperatives which indicate that a corporation should as 'part of the business of business' act in an ethical and socially responsible way. Examples of corporate misconduct will illustrate that there are instances where a company's social responsibilities should take precedence over the goal of profit maximization. It will be posited however, that in most circumstances these goals are complementary rather

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¹ P Redmond, *Company and Securities Law*, 3rd ed, Lawbook Company, Sydney, 2000, p 87; C Stone, 'Corporate Social Responsibility: What it might mean, if it were to really matter' (1985-1986) 71 *Iowa L Rev* 557 at 558; M Glazebrook, 'How Australia's top 500 companies are becoming corporate citizens' in Andriof J and McIntosh M (eds), *Perspectives on Corporate Citizenship*, Greenleaf, Sheffield, 2001, p 155.

² J Post, L Preston and S Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth*, Standford Business Books, Standford, 2002, p 19; A Corfield, 'Stakeholder theory and its future in Australian corporate governance' (1998) 10 *Bond LR* 213 at 214. For governmental recognition of such stakeholders see Commonwealth corporations and markets advisory committee, Parliament of the Commonwealth of Australia *The Social Responsibility of Corporations* (2006) at 27 ('CAMAC Report'); UK Company Law Review Steering Group, *Modern Company Law for a Competitive Environment: The Strategic Framework* (1999) at [1.24] ('UK Steering Group Report'); OECD *Principles of Corporate Governance* (2004) at 11. Also see *People's Department Stores Inc v Wise* (2004) 244 DLR (4th) 564 at [42] per Major and Deschamps JJ.

than antithetical to each other.³ Finally, a number of reforms will be considered and suggestions made about their utility to Australian businesses.

The traditional approach to corporate social and ethical responsibility

A company is a separate legal person,⁴ managed by a board of directors who are given broad powers of management in the company's constitution.⁵ Although this gives great authority to managers, from a legal perspective the company's interests have always been equated with the collective interests of its shareholders.⁶ Directors are accordingly subject to fiduciary duties⁷ and are ultimately answerable to shareholders at a general meeting who have the power to remove a director⁸ or to authorise an act that would otherwise be ultra vires and illegal.⁹ When combined with the doctrine of limited liability this structure made the corporation an extremely popular business vehicle as it enabled a large group of investors to profit from the expertise of professional directors and to get access to projects which by themselves they would never have the capital to realize.¹⁰

It was from this legal framework and the commercial bonanza brought about by the industrial revolution in the 19th century that the mentality developed that a company has no other responsibility than to make as much profit for their shareholders as possible.¹¹ Shareholder primacy was justified on the basis that shareholders provide the capital that is required to finance a company's daily operations and since they

³ M Eisenberg, 'Corporate Legitimacy, conduct and governance - two models of the corporation' (1983-1984) 17 *Creighton L. Rev* 1 at 6.

⁴ *Salomon v Salomon & Co Ltd* [1897] AC 22; *Lee v Lee's Air Farming Ltd* [1961] AC 12

⁵ See replaceable rule in *Corporations Act 2001* (Cth), s 198A.

⁶ *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457; *Nugurli Ltd v McCann* (1953) 90 CLR 425; *Greenhalgh v Arderne Cinemas* [1950] 2 All ER 1120; *Burnninghausen v Glavanics* (1999) 32 ACSR 294; *Southern Cross Mine Management Pty Ltd v Ensham Resources Pty Ltd* (2004) 22 ACLC 724.

⁷ See A Berle, 'Corporate Powers as Powers in Trust' (1930-1931) 44 *Harv L Rev* 1049. The fiduciary obligations a director owes to a company has largely been codified and can be found in ss 181 (duty to act in best interests of a corporations and for proper purpose), 182 (director must not improperly use to their position to benefit themselves or another or act to the detriment of the company) 183 (duty to only use information obtained as a director for best interests of company and proper purpose) and s 184 of the *Corporations Act 2001* (Cth).

⁸ See replaceable rules in s 201G of the *Corporations Act 2001* (Cth).

⁹ *Bamford v Bamford* [1970] Ch 212.

¹⁰ P Davies, *Gower's Principles of Modern Company Law*, 6th ed, Sweet & Maxwell, London 1997, p 10.

¹¹ M Friedman, *Capitalism and Freedom*, University of Chicago Press, Chicago, 1962, p 133.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

have a low probability if a company becomes insolvent from recovering their investment¹² it is only fair that they should command the loyalty of a company as it is one for which they have *paid*.¹³ As shareholders want profitable returns on their investments, any effort by a director to consider interests beyond this goal was malevolent as they were 'spending somebody else's money' and breaching an essential term of contract that supposedly gave shareholders a quasi-proprietary right in the company.¹⁴ Nowhere was this epitomized more than in the famous case of *Dodge v Ford*¹⁵ where an attempt by Henry Ford to extend corporate benefits to other constituents (namely employees and consumers) by way of expanded work opportunities, higher wages and lower purchase prices was rejected by the court who ruled:

A business corporation is organized and carried on primarily for the profit of the stockholders the power of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.¹⁶

Although harsh in its result, this case is not unique. *Parke v Daily News Ltd*¹⁷ and the famous dicta of Bowen LJ in *Hutton v West Cork Railway Co*¹⁸ that 'there are to be no cakes and ale except such as required for the benefit of the company' and that 'charity has no business to sit at a board of directors' are all testament to assiduousness of this argument. Proponents of this position argue that since corporations have shown a special proficiency for wealth creation they should continue to concentrate on the production of profits and leave social engineering to governments and other institutions who have a democratic mandate and historic role

¹² See Redmond, above n 1, at p 109 and s 556 of the *Corporations Act 2001* (Cth) which gives the claims of many creditors priority over shareholders.

¹³ Stone, above n 1 at 566; Also see E Fama and M Jensen, 'Separation of Ownership and Control' (1985) 26 *Journal of Law and Economics* 301 at 304.

¹⁴ Fama and Jensen, above n 13, p 135; also see discussion in R Mangrum, 'In search of a paradigm of corporate social responsibility' (1983-1984) 17 *Creighton L Rev* 21 at 27-29.

¹⁵ 170 N.W.668 (1919).

¹⁶ 170 NW 668 (1919) at 684 per Ostrander CJ, 685 per Steere, Fellows, Stone, Brooke JJ concurring.

¹⁷ [1962] Ch 927 where a board's attempt to make a series of ex gratia payments to employees who were made redundant by the sale of the company's newspaper business were struck down by the court as ultra vires.

¹⁸ (1883) Ch D 654 at 671 per Bowen LJ.

in this area.¹⁹ After all corporations already make valuable contributions to the well being of society, as they provided citizens with employment and efficient goods and services.²⁰ Thus from its very inception corporate law was created to encourage the accumulation of capital and to take advantage of commercial opportunities.²¹ Community interests were ignored either because they were perceived to be anathema to wealth creation or because there were other more appropriate avenues for protecting their interests.

Challenging the traditional paradigm- the Corporation as an institution

The problem with the above approach is that it does not accurately reflect reality and underestimate the far reaching impact that corporations have on society. Modern corporations wield great economic power and it would be anomalous to believe that this does not create additional social and ethical responsibilities on corporate directors to consider how a company's strategy would resonate beyond their shareholder constituency.²² The notion of shareholder control is fast becoming a legal fallacy as in most large public companies there is now clear separation between ownership and control.²³ This has resulted from the phenomenal growth of the stock market and the size of many corporations whose joint capital is so large that it is impractical for one shareholder to hold a controlling stake in the enterprise. Since share ownership is spread over such a scattered and diverse constituency, practice has shown that shareholders have lost the ability to act as a collective group. Adding to this trend is the fact that most shareholders are not inclined, or do not have the skills to interpret the detailed financial documents and review the complex commercial decisions arrived at by directors of many public companies. The traditional legal paradigm whereby managers are accountable and controlled by shareholders is therefore no longer true. In its place have arisen professional corporate managers whose power to design the strategy and direction of the corporation (subject of course to the law) is virtually unlimited.

¹⁹ Friedman, above n 13, at p 139; F Hayek, 'The corporation in a democratic society: In whose interest ought it and will it be run' in H Ansoff, *Business Strategy*, Penguin, Harmondsworth 1969.

²⁰ P Rostow, 'To whom and for what ends is corporate management responsible?' in E Mason (ed), *The Corporation and Modern Society*, Oxford University Press, 1959.

²¹ See B Horrigan, 'Fault lines in the intersection between corporate governance and social responsibility' (2002) 25 *UNSWLJ* 515 at 521-522.

²² T Cannon, *Corporate Social Responsibility*, Pitman, London 1994, p 38.

²³ A Berle and G Means, *The Modern Corporation and Private Property*, 2nd ed, Brace and World, New York, 1967.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

From a theoretical perspective, the importance of Berle and Means is that it opened the way for corporations to be seen as an organic entity with a number of constituent parts²⁴ and not merely the accumulation of its membership.²⁵ As a corollary it became increasingly difficult to justify shareholder primacy to the exclusion of all other stakeholders, as a company could no longer be portrayed as an isolated, self-contained institution. Rather, it could be seen as encompassing a number of stakeholders with responsibilities legitimately owed to the community at large. The role of directors was to balance and coordinate these interests as stewards for the company as whole. As Dodds recognized:

That the duty of the managers is to employ the funds of the corporate institution which they manage solely for the purposes of their institution is indisputable. That that purpose, both factually and legally is maximum stockholder profit has commonly been assumed by lawyers. That such is factually the purpose of the stockholders in creating the association may be granted. Nevertheless, the association, once it becomes a going concern, takes its place in the business world with certain ethical standards which appear to be developing in the direction of increased social responsibility. If we think of it as an institution which differs in the nature of the things from the individuals who compose it, we may then readily conceive of it as a person, which, like other persons engaged in business, is affected not only by the laws which regulate business but by the attitude of public and business opinion as to the social obligations of business. If business is tending to become a profession, then a corporate person engaged in business is a professional even though whom it acts may therefore employ its funds in a manner appropriate to a person practicing a profession and imbued with a sense of social responsibility without thereby being guilty of a breach of trust.²⁶

The remainder of this essay will be devoted to why a corporation would have an interest in acting in a socially responsible way and how this can be promoted through the law.

²⁴ See the classic judgment of Lord Reid in *Tesco Supermarkets Ltd v Natrass* [1972] AC 153 for the organic theory of a corporation.

²⁵ J Dean, *Directing public companies: Company law and stakeholder society*, Cavendish, London, 2001, p 4; M Stokes, 'Company Law and Legal Theory' in S Wheeler (ed), *A reader on the law of the business enterprise*, Oxford University Press, Oxford, 1994), pp 107-108; L Sealy, 'Directors' wider responsibilities- problems conceptual, practical and procedural' (1987) 13 *Mon LR* 164 at 170.

²⁶ E Dodds Jr, 'For whom are corporate managers trustees?' (1931-1932) 45(7) *Harv L Rev* 1145 at 1161.

Why good corporate citizenship is good business practice²⁷

A corporation is a social institution in the sense that it involves the interplay between a number of distinct, yet symbiotic relationships.²⁸ For example, a corporation in trade and commerce provides goods and services to a group of consumers. However, to do so it requires employees and managers to produce those goods. If a corporation has skilled and knowledgeable employees they may succeed in creating a more efficient business, enabling the company to charge lower prices for better quality products.²⁹ When combined with successful marketing this is likely to increase a business' market share and augment company profits. If we were to take this further we could analyse where a corporation obtains its supplies and the debt capital required to fund its larger projects and it could be seen that access to creditors and the natural environment³⁰ are also essential to the functioning of a business. These examples illustrate that corporations thrive on myriad forms of capital- economic capital, human capital, moral capital, intellectual capital and environmental capital³¹ and the larger a corporation is, the more important such relationships become.³² It is perhaps then unsurprising that savvy business leaders already believe that engaging with the community is a fundamental part of the business of business and are implementing policies to facilitate this process.³³ A classic example of this is the insurance industry who after paying out over \$22.8 billion to policy holders for property damage caused by extreme weather has decided that their ongoing viability is dependent on cooperating with environmental groups to combat global warming.³⁴ Hence, the belief that a company must sacrifice its earnings in order to be ethically or

²⁷ M Kaul, Director General of the Commonwealth business council cited in Horrigan, above n 22 at 515.

²⁸ Horrigan, above n 22 at 527; I Wilson, *The New Rules of Corporate Conduct: Rewriting the social charter*, Quorum, London 2000, p 3.

²⁹ M Blair, *Ownership and Control: Rethinking Corporate Governance for the 21st Century* Brookings Institute, Washington 1995, p 16.

³⁰ Particularly in industries like mining and logging which rely on the natural environment as a source of its most basic product.

³¹ Horrigan above n 22 at 517. Also see Corfield, above n 2 at 215.

³² Wilson, above n 27, p 4.

³³ Lord Wedderburn of Charlton, 'The social responsibility of companies' (1985) 15 *MULR* 4 at 6. Also see the comments of Barry Cusask, CEO of Rio Tinto, Greg Bourne, President of BP Australia and Graeme Thompson, Deputy Governor of the Reserve Bank of Australia all in Glazebrook, above n 1, pp 154-155.

³⁴ See statement of Elias in Glazebrook, above n 1, p 162.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

socially responsible is short sighted as engaging in the community is the path to long term wealth creation and ultimate business success.³⁵

Enhanced productivity and long term wealth creation is not the only reason why it is commercially prudent for a company to engage with the community. A failure by a company to identify and properly manage non-financial risk may cause short or longer term detriment to the company, such as increased direct or indirect operating costs, regulatory intervention, adverse litigation, harm to corporate reputation or brand image, or reduced employee loyalty or community support.³⁶ In Australia the risk of regulatory intervention is particularly strong, as various statutory regimes impose obligations on corporations to comply with social norms and to meet minimum benchmarks.³⁷ Breach of these norms can result in a corporation being subject to severe pecuniary penalties, public odium and the disruptive intervention of government watchdogs like the Australian Competition and Consumer Commission, the Australian Securities and Investment Commission, the Office of Workplace Services and the various state WorkCover authorities.³⁸ If taken to extremes a company that acts irresponsibly may even lose its license to operate. This was seen most poignantly in the AWB Wheat scandal, as once it was exposed that the company had been bribing officials of Saddam Hussien's former regime, irresistible public pressure has built on the government to end AWB's trade monopoly, an outcome which was previously unthinkable.³⁹ Similarly, when James Hardie Industries Ltd (JHIL) refused to compensate former employees who were suffering from exposure to asbestos, the NSW government imposed an embargo on the use of their products and threatened to pass legislation that would reverse their corporate

³⁵ J Jacques du Plessis, J McConvill and M Bagaric, *Principles of Contemporary Corporate Governance*, Cambridge University Press, Cambridge, 2005, p 22. Also see CAMAC Report, above n 2 at 29 and UK Steering Group Report, above n 2 at [5.1.22]; Horrigan, above n 22 at 525.

³⁶ CAMAC Report, above n 2 at 22.

³⁷ For consumers and competitors see the *Trade Practices Act 1976* (Cth), for creditors and some employee entitlements see Part 5 of the *Corporations Act 2001* (Cth). For employees generally see state occupational health and safety and workers compensation legislation as well as Part 7 of the *Workplace Relations Act 1996* (Cth). For the environment, see the *Environmental Protection and Biological Conservation Act 1999* (Cth).

³⁸ Jacques du Plessis et al, above n 35, at pp 33-35; B Baxt, "Corporate law a fragile structure", *The Australian Financial Review*, 19 November 2004, p 55.

³⁹ A Grigg, 'AWB fees under fire as hard times bite', *The Australian Financial Review*, 20 September 2006, p 15.

restructure,⁴⁰ notwithstanding that an independent inquiry found that they were within their legal rights to act in the way they did.⁴¹ Consequently, in determining business strategy directors must consider how irresponsible actions may impact upon the long term position of the company. If it could be undermined by not engaging with the community, it would seem that a director would be negligent if they only looked at the short term impact such a strategy had on the company's bottom line.

This is not to say that the negative response of the public and in turn the market cannot be an equally strong incentive for a corporation to act responsibly. For example, the coronial inquest into the untimely death of Dianne Brimble, a passenger on a P & O cruise, has undoubtedly done enormous damage to the reputation of the cruise liner, regardless of the fact that it was a group of young men, acting independently who appear to be responsible for her death. It has been widely publicized, especially when combined with a similar allegation made by a previous passenger, that Mrs Brimble's death was not an isolated incident but semiotic of a culture of sleaze and debauchery that the company has intentionally fostered on its ships.⁴² Even though, P & O has attempted to counter this image but introducing a strict search regime for passengers boarding their vessels and by withdrawing a series of ads showing bikinis clad models sun baking on deck,⁴³ P & O's chances of countering the negative publicity seems to be spurious at best.⁴⁴ Ticket sales for future cruises have already declined and the company has made a confidential settlement with the Brimble family worth thousands of dollars even though there are a number of foreseeable hurdles that could make it difficult for her family to successfully litigate.⁴⁵ The fast food industry is another recent example of how public pressure can influence corporate strategies. The immense success of documentary films like *Super Size Me*⁴⁶ and *Fast Food Nation*⁴⁷ has placed enormous pressure on many of the largest transnationals to modify their menus and to accurately disclose

⁴⁰ Jacques du Plessis et al, above n 35, p 49; E Dunn, 'James Hardie: No Soul to be damned and no body to be kicked' (2005) 27 *Syd LR* 339 at 442.

⁴¹ Report of the Special Committee of Inquiry into the Medical Research and Compensation Foundation (2004) at [1.1.4].

⁴² L Davies, 'Brimble Bombshell: P & O accused of hiding tragedy and inviting men on board for orgies- Cruise ship's day of shame', *The Daily Telegraph*, 14 June 2006, p 3; D Passmore, 'Missing on the High Seas', *The Sunday Mail*, 2 April 2006, p 54.

⁴³ L Davies, 'Postcard apology for P & O', *The Daily Telegraph*, 15 June 2006, p 5.

⁴⁴ A Mascarenhas, 'P & O regulations fall short', *The Age*, 29 February 2007, p 4.

⁴⁵ P Morley and P Sherwin, 'Brimble compo win', *The Courier Mail*, 23 February 2007, p 13; D King and M Stothard, 'Brimble family to take payout', *The Australian*, 23 February 2007, p 3.

⁴⁶ (2004), written and directed by Morgan Spurlock.

⁴⁷ (2006), written by Eric Schlosser and Richard Linklater, directed by Richard Linklater.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

the injurious impact that excessive consumption of their products can have on society. Thus far there has been some encouraging signs. McDonalds has introduced a range of somewhat more healthy meal alternatives⁴⁸ and a number of fast food companies have recently entered into an arrangement with the Commonwealth government in which they have undertaken to remove harmful trans-fats from their cooking oil.⁴⁹ Although such acts could be derided as insignificant, de minimis gestures, they do provide examples of corporations who under no direct legal compulsion change their policies to act responsibly. They accentuate that the market can act as regulatory mechanism, which when buttressed by the threat of government intervention can encourage corporations to act with ethical and moral cupidity. Corporate social responsibility is therefore a real and tangible concept, which companies are expected to comply with regardless of whether the source of this compulsion is the desire to maximize profits or to be vigilant and moral corporate citizens.

Regulating to encourage corporate social and ethical responsibility

Directors Duties

a. The proposal

This is one of the most common suggestions made on how to encourage a corporation to engage with the community and could be achieved by adopting an expanded definition of the 'best interests of the company' in s 181 of the *Corporations Act 2001* (Cth) or by including a stakeholder clause in a company's constitution. Although it seems radical, proponents contend that it would merely codify what directors already do and subsequently would not demand a major change in the way that effective public companies are already run.⁵⁰ In addition, there are international precedents to support such an approach. For example, in *Peoples Department Stores Inc. (Trustee of) v Wise*⁵¹ Major and Deschamps JJ in the Supreme Court of Canada, although ruling against the company's creditors in that case, noted:

Insofar as the statutory duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interest of

⁴⁸ See the '9 tick approved meal promotion' at <http://www.mcdonalds.com.au/HTML/home/default.asp> viewed at 2 April 2007.

⁴⁹ The Commonwealth Department of Health and Ageing, 'Quick serve restaurants agree to work on transfats' (Press Release, 12 March 2007).

⁵⁰ Dean, above n 24, p 14.

⁵¹ (2004) 244 DLR (4th) 564.

(2007) 19.2 BOND LAW REVIEW

the shareholders". From an economic perspective, the best interests of the corporation" means the maximization of the value of the corporation:

see E.M. Iacobucci, "Directors Duties in Insolvency: Clarifying what is at stake" (2004), 39 Can. Bus. L.J 398, at pp. 400-401. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. For example, in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C), Berger J, stated at, p 314:

A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.

I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

The case of *Re Olympia and York Enterprises Ltd and Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254, 37 D.L.R. (4th) 193 (Div. Ct), approved at p 271, the decision in *Teck*, supra.

We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation, it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interest of shareholders, employees, suppliers, creditors, consumers, governments and the environment.⁵²

To further this approach legislation could be drafted to ensure that directors are subject to objective standards and clear guidelines as to when it is permissible to consider stakeholder interests. A way of creating such standards would be through the addition of a business judgment rule⁵³ analogous to one currently being used in analysing whether a director has breached their duty of care.⁵⁴ A similar approach

⁵² (2004) 244 DLR (4th) 564 at 581 per Major and Deschamps JJ.

⁵³ Corfield, above n 2 at 222; J Kay, 'The Stakeholder Corporation' in Kelly G, Kelly D and Gamble A, *Stakeholder Capitalism* Oxford University Press, Oxford, 1997, p 137.

⁵⁴ *Corporations Act 2001* (Cth), s 180(2).

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

has already been used for a number of years in the United States where many States have passed corporate constituency statutes which allows directors to consider a number of stakeholders before acting on a takeover bid and in the United Kingdom where the *Companies Act 2006* (UK) has recently been passed by parliament. Such legislation protects directors from accusations that they have breached their fiduciary duties by considering non-shareholder interests in making corporate decisions. They are therefore defensive in effect as they do not place a director under a proactive obligation to promote the interests of other stakeholders. Even though these Acts have been criticized for being too moderate, it would go a long way to engraining ethical and social responsibility into the psyche of many corporate leaders, who according to empirical research commonly believe that they would be breaking the law if they consider stakeholder interests beyond the company's shareholders.⁵⁵

b. Application to Australia

The major problem with this option is how an aggrieved stakeholder would enforce it. Court rules would have to be modified to give a wider group of stakeholders standing to commence proceedings if a section as broad as s 172 of the *Companies Act 2006* (UK) could ever be enforced in Australia. Mitchell⁵⁶ has already looked at this option and concluded that expanding access to derivative actions would only work if standing was limited to the lowest common denominator- that is to constituents who could prove that policies of the board was causing them serious harm.⁵⁷ If prerequisites for standing were too low, any decision could be challenged, which in considering how many stakeholders there are in a large corporation could make daily management inefficient and costly. Secondly, even if the higher threshold for standing is accepted, what commentators forget is the limits of the courts' jurisdiction and in particular what matters are and are not justiciable. Section 172 of the UK Act provides no instruction as to how a company's directors, let alone the courts are meant to balance and prioritize the interests of competing stakeholders. Where duties are owed to persons with potentially opposed interests, the duty bifurcates and fragments so much that it amounts to ultimately no more than a vague obligation to be fair.⁵⁸ Judges loath to make such overt policy judgments as it requires them to ignore centuries of tradition and to perform a complex balancing act, which they may

⁵⁵ Who according to the research of Dean still believe that it is illegal for them to look beyond their exclusive obligation to shareholders. See above n 24, at p 15.

⁵⁶ L Mitchell, 'A critical look at corporate governance' (1992) 45 *Vand L Rev* 1263.

⁵⁷ Also see Dean, above n 24, at p 19.

⁵⁸ Sealy, above n 24 at 175.

be not been any more qualified to do than the directors who made the original decision.⁵⁹

Another thing to consider is whether changing s 181 of the *Corporations Act 2001* (Cth) would defeat the purpose for which it is created - that is to control directors and ensure they do not misuse their position. If the mandate of directors is inexorably broadened surely it will only make it more difficult for shareholders to review and control the actions of management.⁶⁰ Practice in the United States has shown that such powers are usually used as a defensive measure⁶¹ and in considering that the law is already difficult to apply with *Harlowe's*⁶² and *Ampol*⁶³ it is hard to see what benefit could be gained by making director's duties even more nebulous and confusing.⁶⁴ Furthermore, it is questionable as to whether such a change is actually needed. As mentioned above, various statutes⁶⁵ all impose personal obligations on directors to act responsibly and to consider community interests. By contrast, shareholders are only protected by the *Corporations Act 2001* (Cth) and to further water down the obligations that directors owe to shareholders would be to abandon what last remaining control they retain.⁶⁶ Regulating corporations by changing the *Corporations Act 2001* (Cth) is consequently not the best way to protect the community as it would amount to legislative overkill without offering any tangible benefits to interested stakeholders.⁶⁷

Changing Board Composition

a. The proposal

Since the board of directors is the brain of the company⁶⁸ the only way to reform business culture is to change the head rather than the body of the corporation.⁶⁹ One

⁵⁹ Lord Wedderburn of Charlton, above n 32 at 20.

⁶⁰ J McCabe, 'Are corporations socially responsible: Is corporate social responsibility desirable?' (1992) 4 *Bond LR* 1 at 17.

⁶¹ Sealy, above n 24 at 176.

⁶² *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483.

⁶³ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

⁶⁴ For US examples see ABA Committee on Corporate Laws, 'Other constituency statutes: Potential for confusion' (1990) 45 *Business Law* 2253 at 2269.

⁶⁵ See above n 35.

⁶⁶ See Senate Standing Committee on Legal and Constitutional Affairs, *Company Director's Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989), [6.45]-[6.47].

⁶⁷ Jacques du Plessis, et al, above n 34, at p 52.

⁶⁸ *Tesco Supermarkets Ltd v Natrass* [1972] AC 153.

⁶⁹ Dean, above n 24, at p 17.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

way to change the composition of the board is to increase and even mandate through corporate constitutions or the *Corporations Act 2001* (Cth) how many independent non-executive board members a company must have. It is presumed that since non-executive directors remain detached from discussions behind many corporate decisions they can adopt a more objective opinion as to what are the ethical and social ramifications of a business strategy. As John Pound explains 'involving outsiders reduces the danger of insularity in managerial decisions and can mitigate the behavioural problems that cause companies to cling to bad decisions'.⁷⁰ Certainly, an expanded role for non-executive directors is not as radical as it first may seem, as with the increasing reach of the statutory duty of care⁷¹ it could be argued that non-executive directors are already obligated to keep up to date with the company's position and to diligently fulfil their supervisory role. Regulating for an independent voice to be mandatory on the board of directors of large companies would be a useful tool for promoting social and ethical responsibility as executive decisions will be subject to scrutiny and review.⁷²

b. Application to Australia

It is doubtful whether the presence of non-executive directors would make any real difference in practice. The collapse of One Tel and the insurance giant HIH all demonstrate how difficult it can be for non-executive directors to monitor a company accurately when a group of executive directors are colluding to act irresponsibly and providing them with fraudulent information.⁷³ Moreover, for this supervisory role to be given its maximum effect, non-executive directors must be given permission to consider a broad range of stakeholder interests and as discussed above this in itself may raise some irresolvable problems. In particular if non-executive directors are appointed to represent a specific constituency (for example, some people have advocated an environmental spokesman or a workers delegate to be placed on every board) those directors are not really independent as they have responsibilities which are contradictory to the fiduciary duty they owe to the company as a whole.⁷⁴ Advocates point towards examples of German and Japanese companies that have resolved this problem and actually increased productivity by creating a two tiered

⁷⁰ J Pound, 'The promise of the governed corporation' (1995) 73(2) *Harv Bus Rev* 89 at 98.

⁷¹ *Corporations Act 2001* (Cth), s 180(1). As epitomized by the rulings in *Daniels v Anderson* (1995) 37 NSWLR 438 and *ASIC v Rich* (2003) 44 ACSR 341.

⁷² I Stratton, 'Non-executive directors - Are they superfluous?' (1996) 17 *Company Law* 162 at 165.

⁷³ See J Jacques du Plessis, 'Reverberations after HIH and other recent corporate collapses: The role of ASIC' (2003) 15 *Aust Jnl of Corp Law* 8.

⁷⁴ See above n 53.

system of corporate governance based on the idea of co-determination.⁷⁵ However, the possibility of actually applying such radical management structure to Australian business seems unlikely at best as it would require corporate nomenclature to be transformed completely. Australian business has traditionally adopted a more confrontational approach to industrial relations and unsurprisingly there still seems to be continuing scepticism amongst company executives to accept the view that workers and possibly unions should be given a greater role in the corporation.⁷⁶ Hence, if the only way for this reform to be a realistic option is to water it down to the extent that it is largely tokenistic, it is not a suitable vehicle for encouraging corporations to engage with the community.

Institutional Investors- Socially Responsible Investment (SRI)

a. The proposal

Some theorists have argued that institutional investors, due to the size of their holdings and by virtue of their financial expertise, are uniquely empowered to place pressure on company directors to engage with the community.⁷⁷ Certainly, if institutional investors weigh the environmental, social and ethical performance of target companies in deciding whether to invest, those companies who crucially need large scale investment to grow, have an incentive to act responsibly. SRI is currently endorsed by the Australian Council of Super Investors⁷⁸ and s 1013D of the *Corporations Act 2001* (Cth) requires insurers in offering products to other institutional investors with an investment component to take into account social and ethical considerations in determining their policies. From a commercial perspective, as institutional investors can not readily dispose of their enormous stakes⁷⁹ and because the long term return on their investments may be substantially affected by a target company's exposure to non-financial risks, it is practical to assume that they would take SRI seriously. The recent promotional campaign of Westpac Banking Corporation where the Bank has proudly announced that they are highly ranked in

⁷⁵ Corfield, above n 2 at 232-236; C Mallin, *Corporate Governance*, Oxford University Press, Oxford 2004, p 45.

⁷⁶ Dean, above n 24, at pp 240-247.

⁷⁷ G Stapledon, 'Australian share market ownership' in G Walker, B Fisse and I Ramsay, *Securities Regulation in Australia and New Zealand* (1998), p 245 in an extended study of share ownership in Australia estimated that institutional investors held over 45% of all listed Australian equities and are also the most common of any group to hold a substantial holding in many public companies- the top six institutional investors holding half of such interests.

⁷⁸ Australian Council of Super Investors, *Corporate social responsibility: guidance for investors* (2005) at 24.

⁷⁹ Redmond, above n 1, at p 82.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

the Dow Jones Sustainability Index, subscribe to the *Equator Principles* and will not give any loans to companies whose products contribute to the Greenhouse effect is the most recent example of an Australian institutional investor practising SRI.

b. Application to Australia

Whether institutional investors are capable and willing to play such a regulatory role is still unclear and seems to depend on the proclivities of each company and the nature of the situation. In one of the only empirical studies⁸⁰ on this subject focusing on the activities of 12 major Australian institutional investors, results indicated that institutional investors only vote against a recommendation of senior management when they perceive it is in their financial interests to do so. Only three institutional investors had formal systems for monitoring corporate governance problems and none had consulted with company stakeholders beyond the top management echelon of their investee companies in deciding whether to vote in favour or against management.⁸¹ What these result indicate is that it would be naive to rely on institutional investors to regulate corporate social responsibility as like all corporations they act to further their own commercial interests. It is controversial to even suggest that they have the mandate or resources to police the activities of other companies.⁸² Surely in considering the far reaching impact that banks, insurance and superannuation companies have on society at large, it would be far better off to focus on their own obligations if they really want to make a contribution to the community. The Australian and New Zealand Banking Group Ltd (ANZ) are to be commended in this respect. On 18 April 2007, they announced their 'ANZ Reconciliation Action Plan' in which they pledged to recruit and promote indigenous employees and to assist indigenous communities with financial literacy programs.⁸³ The author would like more institutional investors to promote similar programs.

Enhancing Disclosure Requirements

a. Proposal

Unlike the other proposals this option is quickly becoming a major part of current commercial practice. Sections 299(1)(f) and 299A of the *Corporations Act 2001* (Cth)

⁸⁰ I Ramsay, G Stapledon and K Fong, *Institutional investors' views on corporate governance*, Butterworths, Sydney 1988.

⁸¹ Ramsay et al, above n 80, at pp 17-28.

⁸² B Black and J Coffee, 'Hail Britannia: Institutional Investor behavior under limited regulation' (1994) 92 *Mich L Rev* 1997 at 2086.

⁸³ Australia and New Zealand Banking Group Ltd, 'ANZ Reconciliation Action Plan an Australian First' (Press Release, 18 April 2007).

requires companies listed on the stock exchange to provide ASIC and all their shareholders with annual directors' reports. These reports are available to the public and must outline what measures the company is taking to comply with both its financial and non-financial obligations. These disclosure obligations are supplemented by ASX Listing Rules and the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations*. Principle 10 is particularly important as it states that:

Companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole. There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital.

When combined with Principle 7 and the ASX Listing Rule 4.10.3, listed companies are under a continuous obligation to audit their activities and to explain to the public how they are protecting community interests. ASX recommendation 10.1 requires companies to publish a code of ethics and if a company fails to comply with any of these conditions the onus is upon its board to clearly explain the reasons for their non-compliance. Innovative auditing techniques are also currently being developed to confirm the veracity of such statements.⁸⁴ A company that ignores these standards may be penalized under ss 793C and 1101B of the *Corporations Act 2001* (Cth), so it would be erroneous and potentially negligent for a director to ignore their responsibilities to report on corporate activities.

In the authors view this approach to regulation is the most appropriate for Australian conditions and will go a long way to creating an enduring culture of corporate responsibility. Unlike the other suggestions compulsory corporate disclosure does not require the fundamental basis of corporate law to be completely reformed. In this respect it is more practical as it is unlikely to face such staunch opposition because it can be easily reconciled within the current system of directors duties. In addition, because of the commercial and moral considerations mentioned above directors still have great incentives to act in a responsible way. Stakeholders who are unfairly prejudiced are still able to pursue remedies through more specific legislation and may even be aided by such disclosure in bringing corporate irresponsibility to light. Companies care about their public image and as societal values change the media and public are becoming more concerned with the way that companies conduct their business.⁸⁵ The success of this approach in changing corporate cultures can already be seen by the practices of Telstra, the Commonwealth Bank and the National Australia

⁸⁴ See CAMAC Report at 141-143.

⁸⁵ Wilson, above n 27, at p 60; Also see C Reich, *The Greening of America*, Penguin Books, London 1970.

MAKING CORPORATE SOCIAL RESPONSIBILITY AN EVERYDAY PART OF THE BUSINESS OF BUSINESS: OFFERING REALISTIC OPTIONS FOR REGULATORY REFORM

Bank all of whom take their responsibilities to the community very seriously and have spent a substantial amount of their time reporting on their activities and preparing a code of ethics that is currently available on their websites.⁸⁶ At the very least such reporting mechanisms will bring many issues to the surface and will force directors to think outside of the traditional paradigm. It will make them realize that acting responsibly is not only condoned but is actually encouraged by the law.

Conclusion - Limits of Regulation

The ethical and social responsibilities of modern corporations are now an inescapable part of the 'business of business'. Corporations are social institutions, which act as an interface for a number of different stakeholders all of whom are necessary for the profitable operation of a company. Companies have an enormous impact on the natural and social environments in which they operate and subsequently it is inevitable that the public would expect them to operate within certain norms. A major part of the business of business is therefore about directors finding the best way for the company to engage profitably with the community. As every business is different it is the unique task of each business to find its own way to engage with its environment. Thus the best regulations are those that are broad enough to take into account the idiosyncrasies of each individual company. Legislating to broaden directors duties and to change corporate structures sound innovative, however in reality fail provide practical guidance on how a director should manage conflicts within a corporation. Practical instruction can only come through corporate practice and consultation with various stakeholders. In this regard mandatory disclosure is the best way to encourage corporations to comply with public ethical and social standards. Accurate reporting stimulates discussion and exposes corporation who intentionally or negligently harm corporate stakeholders. Specific legislation can act as a safeguard to punish and in turn deter corporations from acting immorally. Thus, corporations should be regulated, but only to the extent that it constructively contributes and gives protection to individual stakeholders. Radical proposal that offers minimal benefits to stakeholders should not be imposed as its costs may undermine a commercial entity that has served business well for over 300 years.

⁸⁶ For Telstra see its published *2005 Corporate Social Responsibility Report* available at <http://www.telstra.com.au/abouttelstra/csr/docs/csr_report_2005.pdf>; For Commonwealth Bank see <http://about.commbank.com.au/group_display/0,1922,NI2038%255FCH2038,00.html> and for the National Australia Bank see National Australia Bank, *Corporate Social Responsibility Report 2005: Our Principles in Practice Governance Social Environment Economic* available at <http://www.nabgroup.com/vgnmedia/download/CSR_2005.pdf>