

# **Regulatory Developments in Corporate Social Responsibility: Directors' and Officers' Duties**

**By**

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## **Abstract**

*Recent developments in Australia have challenged our understanding of the social responsibility of corporations. The paper deals first with the law of directors' duties in terms of its suitability as a basis for effecting and reflecting corporate social responsibility in Australia and New Zealand, concluding that the law of directors' duties does not, and indeed should not, compel corporate decision-making towards overriding social and environmental ends. However, the law of directors' duties does not of itself preclude such actions, provided they are reconcilable within an evolving understanding of the interests of the company. The paper then considers the utility of corporate social and environmental performance disclosure as an avenue of stakeholder engagement, and as such, an alternative basis for advancing corporate social responsibility. In that context, a comparison is provided of the current status and sources of non-financial social and environmental performance reporting requirements in Australia and New Zealand.*

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# **Regulatory Developments in Corporate Social Responsibility: Directors' and Officers' Duties**

## **1. Introduction**

### **1.1 The Australian corporate law reform environment**

With the topic of this paper dealing as it does with regulation it is appropriate at the outset to highlight the activities of two bodies that are instrumental in advising the Australian government on the evolving reform of corporate law. First, the Parliamentary Joint Committee on Corporations and Financial Services (PJC), established under the ASIC Act 2001, in June 2005 initiated an inquiry into Corporate Responsibility taking submissions from over 140 individuals and groups across a wide range of professions and interests as well as conducting a total of nine public hearings. Meanwhile the Corporations and Markets Advisory Committee (CAMAC), also established under Part 9 of the Australian Securities and Investments Commission Act 2001, in responding to a Ministerial Referral, issued in November 2005 a discussion paper titled "Corporate Social Responsibility".

These two Inquiries in combination canvass views on just about the full gamut of issues at play in the contemporary debate as to the role in society of the now ubiquitous corporate form. Necessarily, this paper concerns itself with those narrower, but nonetheless complex, elements arising at the interface of directors' duties and corporate social responsibility, along with identifying emerging understanding of the alternative modes and degree of direction contained in regulation that would fall appropriately short of a legislatively embodied positive duty.

Also by way of introduction, it is appropriate to identify both the critical events and wider underlying contexts seen as giving impetus to these Inquiries. This distinction between response to alleged abuse of the corporate form and more benevolent issues around contemporary expectations as to the participation of corporations in the redressing of social and environmental issues, serves to illustrate the complexity of matters at play, and the need thus for clearly thought through and well articulated targeted responses.

## 1.2 The abuse of limited liability and the corporate social responsibility debate<sup>1</sup>

In considering the emerging corporate social responsibility debate we are compelled, at least in Australia, to turn to the behaviour of James Hardie Industries and its treatment of mass tort liability arising out of its manufacture and distribution of asbestos products. Whilst the PJC's terms of reference do not refer to James Hardie Industries, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, does so in his announcement of a referral to CAMAC<sup>2</sup> seeking their consideration and advice in relation to directors' duties and corporate social responsibility. To place the issues in context, the following extracts from a speech by Rob Hulls, the Victorian Attorney-General, are presented as worthwhile background:

" - - - some people casually slip behind the anonymity of the corporate veil once they reach the office and leave their moral obligations at home".

" - - - I am forced to come back to James Hardie as a case in point because the James Hardie scandal has thrust the corporate social responsibility of directors into the spotlight. James Hardie made money from products that contained harmful, lethal substances causing terrible suffering to its employees, the families of its employees and the members of the public who were exposed to it".

" - - - we must be able to lift the corporate veil<sup>3</sup> to ensure that corporations can't shirk their social responsibilities any longer, especially to those suffering the effects of their deadly products or processes".<sup>4</sup>

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<sup>1</sup> The topic, tort and the 'corporate veil', has been subject to extensive academic debate in the United States. See for example R. Roe "Bankruptcy and Mass Tort" (1984) 84 *Columbia Law Review* 846 and H. Hansmann and R. Kraakman, "Towards Unlimited Shareholder Liability for Corporate Torts" (1991) 100 *Yale Law Journal* 1879, the latter of whom conclude at p 1881 there to be " - - - strong empirical evidence indicat[ing] that increasing exposure to tort liability has lead to widespread reorganisation of business firms to exploit limited liability to evade damage claims".

<sup>2</sup> Press Release No. 009 22 March 2005.

<sup>3</sup> "So-called lifting or piercing the veil is a picturesque label to describe what happens when, for reasons of public or statutory policy, the courts are able to identify classes of cases where corporate form is not decisive to the applicability of a statute or a common law doctrine." Lord Cooke of Thorndon, "Corporate Identity" (1998) 16 *Company and Securities Law Journal* 160 at p 161.

<sup>4</sup> 16 March 2005, Monash University: Workshop on the Social Responsibility of Directors.

The conduct of James Hardie Industries ultimately gave rise to the Jackson QC Report of the Special Inquiry into the Medical Research and Compensation Foundation (the Report). The Report is extensive and far-reaching, amounting to more than 550 pages of text. The outcomes of the Special Inquiry are now the subject of a CAMAC ministerial referral "Proposal for the treatment of future unascertained personal injury claimants".<sup>5</sup>

The CAMAC referral mentioned above, would at least for the time being indicate that problems of corporate behaviour in relation to mass future tort liability have been 'quarantined' from the wider topic of corporate social responsibility with the Committee to investigate the scope of targeted legislative response centring on:

- the procedures to allow the admitting into external administration allowance for unascertained claims;
- greater restriction on transactions that would adversely affect the preservation of corporate assets for the benefit of creditors, and
- the targeting of conduct in relation to corporate restructuring.

These specific developments around corporate behaviour related to the avoidance of mass tort liability would seem quite reasonably to enable both the PJC and CAMAC in their respective Inquiries to address the topic of corporate social responsibility more directly in relation to the second characteristic seen as underlying the debate; that of the evolving understanding or expectations of the role of the corporation within a wider social context – and, it is on this footing that this paper now proceeds.

## **2. The facets of corporate law through which corporate social responsibility might be effected and reflected**

### **2.1 Background**

#### **2.1.1 Theories of the corporation**

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

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<sup>5</sup><http://www.camac.gov.au/CAMAC/camac.nsf/byHeadline/Whats+NewTreatment+of+future+unascertained+personal+injury+claims?openDocument> accessed 10/1/2007.

functioning of the corporation in the economy and wider community. Without attempting to describe and reconcile the merits of the contrasting contractarian<sup>6</sup> and state-conferred privilege<sup>7</sup> theories of the corporation and limited liability, the latter at least provides an applied framework useful to the Australian legal system. Possibly allied to concession theory is the 'doctrine of separate legal entity' which views "the company as a legal being in its own right [so that] an act committed in the name of the company is regarded as its own act"<sup>8</sup> rather than regarding the company as a convenient abstraction.

Arising as it does out of an instrumental function provided for in the Corporations Act<sup>9</sup> "parliament has made limited liability available to those who incorporated as a company limited by shares"<sup>10</sup> and "that [this] policy decision can be vindicated on economic grounds".<sup>11</sup> The aspect of state concession does not however grant an unfettered freedom to incorporators and their companies:

" - - - the state clearly reserves the right to rewrite the ground rules and to constrain the freedom of corporate actors. Even as corporate law lets the participants proceed, it in effect cautions them that they may act at will only if on good behaviour. Corporate law facilitates private behaviour, but with a reservoir of suspicion and a threat of constraint."<sup>12</sup>

A comparatively radical "communitarian" perspective would, in contrast, deny the presumed primacy of shareholder interests and further disregard the notion of corporate legal personality central to the development of company law in common law jurisdictions:

"Grounded in sociology and notions of the corporation as community, communitarianism focuses on vulnerability of non-shareholder constituencies and challenges the contractual theory of the corporation."<sup>13</sup>

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<sup>6</sup> Also referred to as 'nexus of contracts'.

<sup>7</sup> Also referred to as 'concession theory'.

<sup>8</sup> H. Anderson, "The Theory of the Corporation and its Relevance to Directors' Tortious Liability to Creditors" (2004) 16 *Australian Journal of Corporate Law* 73 at p 77.

<sup>9</sup> Chapter 2A – Registering a company.

<sup>10</sup> section 112 Types of companies.

<sup>11</sup> M. Whincop, "Overcoming Corporate Law: Instrumentalism, Pragmatism and the Separate Legal Entity Concept" (1997) 15 *Company and Security Law Journal* 411 at p 417.

<sup>12</sup> W. Bratton, "The 'Nexus of Contracts' Corporation: A Critical Appraisal" (1988-1989) 74 *Cornell Law Review* 407 at p 445.

<sup>13</sup> J. Hill, "Public Beginnings, Private Ends – Should Corporate Law Privilege the Interests of Shareholders?" (1998) 9 *Australian Journal of Corporate Law* 21 at p 24.

### 2.1.2 An important definition

It is appropriate also to commence with a definition of 'corporate social responsibility' as this concept is most synonymous with stakeholder interests. One of the more useful definitions of 'corporate social responsibility' is that provided by J. E. Parkinson:

“ - - - behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation”.<sup>14</sup>

A number of features are noteworthy:

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

A further useful description of the context of corporate social responsibility is provided by Engel:

“the resolution of nearly every issue of corporate social responsibility depends heavily on one's beliefs about how the political process operates and one's convictions about the ideal political process”.<sup>15</sup>

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<sup>14</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) at pp 260-262.

<sup>15</sup> D.L. Engel, "An Approach to Corporate Social Responsibility" (1979 - 1980) 32 *Stanford Law Review* 1.

These descriptions are presented as highly useful in the context of regulatory developments. They focus on the business decision perspectives of risk management and on balancing short- and long-term viability. Moreover, they highlight the complexity of interrelated factors at play in the corporate social responsibility 'debate'. Finally, without wishing to present what might be interpreted as a 'political' view, there is some danger in allowing possibly subjective or extreme views to excessively impact upon the overwhelming positive economic contribution and commercial certainty that has historically been afforded by the corporation and limited liability.

A clear theme underlying these definitions and descriptions is the interrelationship between competing demands on the corporation and the manner, objectives and 'beneficiary' of corporate decision-making – and it is to these complexities that consideration is now given.

### **2.1.3 Corporate decision-making powers and the public interest**

The nature of corporate social responsibility necessarily enters into the domain of political theory and potentially subjective views of the legitimate exercise of powers and the sanctity of property.<sup>16</sup> So that this 'debate' may proceed at a relatively apolitical level, it is suggested that a comparatively non-controversial assertion be accepted that large companies, in particular, are *social enterprises*;<sup>17</sup> a notion by which it is acknowledged that legitimate exercising of their extensive decision-making powers can and should be assessed from the perspective of a wider public interest and concern. The suggestion of this basis of 'assessment' does not of itself conclude any preferred means of compelling or directing corporate behaviour towards the 'public interest'.

In considering the corporation as a *social enterprise*, Parkinson presents two dimensions that can assist in an assessment of the scope and propensity of corporate decision makers to have a regard for stakeholders other than

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<sup>16</sup> In the corporate context, famously described by Dixon J: "They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage." *Peters' American Delicacy Co Ltd. v Heath* (1939) 61 CLR 457 at 504.

<sup>17</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) at p 24.

shareholders. These deal respectively with the idea of profit sacrifice and requirements of disclosure:

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

and further;

“ - - - if we view the company as a public or social body, albeit under private control, then its directors and managers should be held to requirements of disclosure and standards of ethical conduct appropriate to those carrying out public functions”.<sup>18</sup>

#### **2.1.4 The paramountcy of profit maximization?**

In a similar manner, Engel defines corporate social behaviour as behaviour that is distinguishable from a “corporate action taken because of management’s belief that it will maximize profits in the long run even if it may damage them this week or this year”.<sup>19</sup> Nonetheless, it is noted that at least within the narrow perspective of the operation of corporate law, this trade-off between the short- and long-term interests of members allows scope to acknowledge a capacity within the framework of directors’ duties, a regard for wider stakeholder interests. As Parkinson observes:

“ - - - the legal model will in practice accommodate a measure of profit-sacrificing responsibility notwithstanding the duty of management to maximize profits, given that the strict enforcement of that duty is not feasible”.<sup>20</sup>

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<sup>18</sup> Ibid, at p 24.

<sup>19</sup> D.L. Engel, “An Approach to Corporate Social Responsibility” (1979 - 1980) 32 *Stanford Law Review* 1 at p 9.

<sup>20</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) at p 279.



The contemporary reality of a number of industrial sectors within which large companies operate is the degree of market concentration<sup>21</sup> that affords participants the opportunity to pass on part of the cost of social expenditure to customers.

However, within the pivotal sustainability dimension of corporate social responsibility, many of the decisions that are being made by managers are no longer single dimensional issues of either assessing the trade-off between short-term profit sacrifice and future returns or the capacity to shift the burden of incremental costs to customers. Rather, sustainability itself is increasingly identified as a source of business success beyond merely enhancing reputation.<sup>22</sup> While this trend is not universally amongst business, it provides a substantial base upon which future leadership and direction might be developed.

## **2.2 The decision-making powers and duties of directors**

### **2.2.1 The law of directors' duties – an overview**

It is appropriate to give some outline of both the structure and source of directors' general duties as it is within this framework that social responsibility-based decision making might be accommodated. Importantly directors' general duties are sourced from both statute and the general law without the former in any way 'cutting down' or limiting application of the various rules that have emerged from judicial decision. The duties themselves can be placed within two broad categories; first care, skill and diligence, and second, loyalty and good faith. The former is contained in s 180 and, as noted below (2.2.6), draws heavily on a negligence analogy of a duty of care in relation to acts and omissions applied in the context of harm arising out of decisions of a management nature. The second broad category of duty draws more from equitable principles and the notion of a fiduciary relationship giving rise to a complex series of rules which require the directors to act honestly, exercise their powers in the interests of the company, avoid misusing their powers and avoid conflicts of interest.

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<sup>21</sup> Ibid, at p 262.

<sup>22</sup> The report of the PJC's Inquiry into Corporate Responsibility identifies several drivers of corporate responsibility including competitiveness and profitability, attracting investment, attracting and retaining employees and risk management, *Corporate Responsibility: Managing Risk and Creating Value* (Commonwealth of Australia, 2006), para. 3.3-3.56, [http://www.apf.gov.au/senate/committee/corporations\\_ctte/corporate\\_responsibility/report/](http://www.apf.gov.au/senate/committee/corporations_ctte/corporate_responsibility/report/) accessed 10/1/2007.

### 2.2.2 In whose benefit are directors' duties exercised?

J.D. Heydon in "Directors' Duties and the Company's Interests"<sup>23</sup> offers a series of formulations of duty under the preface statement: "Directors must act bona fide for the benefit of the company as a whole."<sup>24</sup> Commenting on the related notion of "best interests of the company" Heydon makes the following remark:

" - - - (it) does not mean the sectional interests of some, or a majority, or even all the present members, but of present and future members; a long-term view should be balanced against the short-term interest of present members. The 'future members' of a company are another reflection of the interests of the company as a distinct corporate entity, separate from the short-term interests of present shareholders. Apart from the interests of shareholders, advancing the interests of the company may require attention to the interests of creditors."<sup>25</sup>

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

### 2.2.3 A duty owed to creditors

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

A duty owed to creditors in situations of corporate insolvency has amounted only to a 'take account of' level. As articulated by Street CJ in *Kinsela v Russell Kinsela Pty Ltd*:

<sup>23</sup> *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 120.

<sup>24</sup> *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J.

<sup>25</sup> *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 123.

“ - - - the interests of creditors intrude - - - through the mechanism of liquidation, to displace the powers of shareholders and directors to deal with the company assets”.<sup>26</sup>

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

“ - - - ‘duty’ of a director to have regard to the interests of creditors when the company is known to be insolvent there can be no reason in principle why knowledge of a real risk of insolvency should not attract the same duty”.<sup>27</sup>

However more recent authority from the High Court concludes that:

“In so far as remarks in *Grove v Flavel* suggest that the directors owe an independent duty to, and enforceable by, the creditors by reason of their position as directors, they are contrary to principle - - - and do not correctly state the law.”<sup>28</sup>

Notwithstanding this unambiguous statement<sup>29</sup> from the High Court, the earlier position taken by Mason J would still hold true that where a director might be regarded as being required to give consideration to the interests of creditors, this will be manifest in a duty owed to the corporation:

“ - - - it should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them.”<sup>30</sup>

<sup>26</sup> (1986) 4 NSWLR 722 at 730.

<sup>27</sup> (1986) 11 ACLR 161 at 170 per Jacobs J.

<sup>28</sup> *Spies v The Queen* (2000) 201 CLR 603 at 636-637.

<sup>29</sup> Decisions subsequent to *Spies* have generated debate at least amongst academics, see A. Hargovan, “Geneva Finance and the ‘Duty’ of Directors to Creditors: Imperfect Obligation and Critique” (2004) 12 *Insolv LJ* 134.

<sup>30</sup> *Walker v Wimborne* (1976) 137 CLR 1.

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

“ - - - the law permits many interests and purposes to be advantaged by company directors, as long as there is a purpose of gaining in that way a benefit to the company”.<sup>31</sup>

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

#### **2.2.4 The interests of the company as a distinct corporate entity**

The above discussion highlights that interests beyond those of shareholders can be contemplated within the interests of the company; the broadness of these interests can be considered from the perspective of the corporate boundary. An evolving understanding of stakeholder interests arising out of the corporation’s interaction with the wider community can be accommodated within the existing framework of directors’ duties. The following Canadian authority foreshadows this emerging flexibility:

“The classic theory is that the directors’ duty is to the company. The company’s shareholders are the company - - - and therefore no interests outside those of the shareholders can legitimately be considered by the directors.”

“In defining the fiduciary duties of directors, the law ought to take into account the fact that the corporation provides the legal framework for the development of resources and the generation of wealth - - -”.

“A classic theory that once was unchallenged must yield to the facts of modern life. - - - I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of the company’s shareholders in

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<sup>31</sup> *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 135.

order to confer benefit on its employees: *Parke v Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for the interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company."<sup>32</sup>

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

"It is a fundamental principle of company law that the directors owe a fiduciary duty to the company. The rule is one protective of the company and its shareholders. But it is also protective of the public interest which is served by integrity in the conduct of company officers."<sup>33</sup>

The remarks above reflect an appropriately controlled and measured openness in the law to accommodate evolving community expectations without adversely affecting the legal instruments and structures through which commerce is transacted.

### **2.2.5 Duties and in whose interest are powers to be exercised?**

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

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

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<sup>32</sup> *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 at 313-314 per Berger J.

<sup>33</sup> *Darvall V North Sydney Brick & Tile Co Ltd & Ors* (1989) 15 ACLR 230 at 231 per Kirby P.

“The categories of fiduciary relationships are infinitely varied and the duties of the fiduciary vary with the circumstances which generate the relationship. Fiduciary relationships range from the trustee to the errand boy - - - (and the nature of the curial intervention will vary from case to case.”<sup>34</sup>

Whilst a line of case development<sup>35</sup> has arisen recognising either a reliance on or detriment basis of a directorial fiduciary duty owed to shareholders individually, “authorities have long accepted that ‘special facts’, such as the director’s possession of information - - - may take a particular case outside of the general rule that directors owe no fiduciary duty to shareholders”.<sup>36</sup> Moreover, in the realm of statutory coverage of directors’ duties characterised by application of fiduciary principles<sup>37</sup>, the type of matters dealt with are typically relationship-based dealing with matters such as the requirements to act in good faith and avoid misuse of powers. As such any development in the law of directors’ duties towards enforceable stakeholder interest potentially creates uncertainty in the conduct of a corporation’s affairs.

### **2.2.6 The managerial function and the constraints on the exercise of these powers**

Both statute and general law reinforce the principle that a corporation is a separate legal entity and that directors are responsible for the management of the company. The corporate entity is freely capable of contracting as a principal in its own right, rather than as trustee or agent for the shareholders. In *Salomon v Salomon*<sup>38</sup> the doctrine is given full weight in the words of Lord Halsbury – “once the company is legally incorporated it must be treated like any other independent person with its own rights and liabilities appropriate to itself”.

This separate legal personality of a corporation is further overlaid by judicial recognition given to corporate management whereby it is only the directors who are

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<sup>34</sup> *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 per Mason J.

<sup>35</sup> *Coleman v Myers* [1977] 2 NZLR 225 and *Bunninghausen v Glavanics* (1999) 32 ACSR 294

<sup>36</sup> R. Goddard, “Percival v Wright: The End of a ‘Remarkable Career’?” (2000) 116 *The Law Quarterly Review* at p 197.

<sup>37</sup> s 181 Good faith, s 182 Use of position and s 183 Use of information.

<sup>38</sup> [1897] AC 22.

able to exercise powers of management, except in the matters specifically allotted to the company in general meeting. Greer LJ in *John Shaw & Sons (Salford) Ltd v Shaw*<sup>39</sup> after reiterating the *Salomon* principle that “a company is an entity distinct alike from its shareholders and directors” goes on to say “powers of management are vested in the directors, they alone can exercise those powers”.

This division of powers is now embodied in legislation:

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

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

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

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

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

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

What then are the constraints that have evolved in relation to the exercise of powers of management? While s 180 signifies the primary statutory source, development of associated case law is insightful in describing a negligence-based duty of care. Prominent amongst the authorities is *Daniels v Anderson*<sup>40</sup> in which the joint judgement of Clarke and Sheller JJA is significant in describing the broad sources of law (tort of negligence) and precedent developments (insolvent trading) which have shaped the law's expectation as to scope and parties affected under common law obligations. Their Honours make the following remarks:

“The source of the duty of care at common law rests in the relationship of proximity. - - - We see no reason why the relationship of a director to a company should not, in accordance with the law as it has developed since

<sup>39</sup> (1935) 2 KB 113 at 134.

<sup>40</sup> (1995) 16 ACSR 607.

*Hedley Byrne & Co Ltd v Heller & Partners* [1964] AC 465, satisfy the proximity test.”<sup>41</sup>

This perspective on the constraints placed on directors in the exercise of powers of management can be examined further:

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

### **2.2.7 Corporate profit and shareholder wealth maximisation**

There is a prevalence of view fostered by neoclassic economists<sup>42</sup>, that the justification for the businesses’ existence is a “single-minded pursuit of profit maximization”<sup>43</sup> against which neither regard nor obligation exists to consider the social and environmental consequences of business. However Lord Wedderburn argues a lessening of the strict notion of management power being exercised for the sole benefit of the owners, and consistent with an understanding of the evolving implications of the extensive legal privilege granted through limited liability, management powers might be held “in trust for the entire community”.<sup>44</sup> Without in anyway approaching an endorsement of the communitarian perspective described above, his Lordship expressed a degree of comfort with the idea that:

“ - - - modern management frequently declares itself a trustee for employees, consumers and stockholders and may even affirm a social responsibility to a wide variety of societal segments which have a stake in the continued health of the corporation”.<sup>45</sup>

Therefore managers’ pursuit of short-term profit maximization is realistically tempered by the need to ensure the future viability of the corporation.<sup>46</sup> This,

<sup>41</sup> (1995) 16 ACSR 607 at 656.

<sup>42</sup> For instance, Milton Friedman

<sup>43</sup> Lord Wedderburn of Charlton, “The Social Responsibility of Companies” (1985) 15 *Melbourne University Law Review* 4.

<sup>44</sup> *Ibid*, at p 6.

<sup>45</sup> *Ibid*.

<sup>46</sup> “... it is proper to have regard to the interests of present and future members of a company, on the footing that it would be continued as a going concern” *Darvall v North*



coupled with an understanding of a duty owed to future members, presents a substantial, but controlled latitude for a responsiveness to changing community expectations of corporate responsibility within management decision making powers.<sup>47</sup>

### **2.2.8 Corporation law as an avenue for achieving environmental and social objectives**

A further question raised is whether corporations law is the appropriate vehicle through which desirable environmental and social outcomes should be compelled or promoted. The neoclassic perspectives have contributed in part to the emergence, particularly in the United States, of *law and economics* scholarship that views the development of law from the perspective of a limited role of statute against which judicial decision would adopt an elevated role of “promot[ing] free markets and efficient use of resources”.<sup>48</sup> Whilst not within the scope of this paper to describe the mixed fortunes of *law and economics* in shaping both statutory and judicial development, it is reasonable to conclude that this theory of legal development has not achieved its proponents’ objective of a ‘wealth maximization’ concept through which certainty is engendered in the law.<sup>49</sup> This characteristic of certainty in the law can be applied to identifying the dichotomy between the proper functions of the corporations law and the attributes of those parts of the wider public law which regulate the conduct of all persons, natural and legal, in relation to environmental and wider social needs. Writing in 1987, Professor Sealy made the still highly relevant observations:

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

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*Sydney Brick & Tile Co. Ltd & Ors* (1987) 12 ACLR 537 at 554 per Hodgson J, (affirmed (1989) 15 ACLR 230).

<sup>47</sup> This observation is also made by the CAMAC in its report on the Inquiry into Corporate Social Responsibility, *The Social Responsibility of Corporations* (2006) at pp 78 and 111, <http://www.camac.gov.au/CAMAC/camac.nsf/03DD84175EFBAD69CCA256B6C007FD4E8?opendocument> accessed 10/1/2007.

<sup>48</sup> N. Andrews, “Bad Company? The Corporate Form in an Uncertain Law” (1998) 9 *Australian Journal of Corporate Law* 39 at p 48.

<sup>49</sup> *Ibid*, at p 49.

and further;

“But there are many snags. It is not the director’s primary role to take care but to take risks. A duty of care and the liberty to take risk are incompatible bedfellows.”<sup>50</sup>

The duty of care as it exists in current corporations law<sup>51</sup> is directed exclusively at a relationship between the directors and the company:

“The closeness of the relationship between the company and its directors and between the act or omission and the damage caused satisfied the requirements of the test of proximity discussed by the High Court in *Sutherland Shire Council v Heyman* (1985) 157 CLR 424. There were no policy considerations disqualifying the relationship from giving rise to a duty of care; *Gala v Preston* (1991) 172 CLR 243.”<sup>52</sup>

A formalised embodiment of social responsibility into directors’ duty of care creates a risk that it would be difficult to determine the obligations of directors and potentially render nugatory the premise of separate corporate personality. The aspect of care in relation to social responsibility-based matters is best pursued through directors ensuring compliance with laws outside the purview of corporations law within well defined environmental and social objectives.<sup>53</sup> Any failure in these regards could potentially render the company subject to a harm that may, in turn, result in the responsible director being sanctioned within the better understood duty of care.

This approach is very much at the centre of a rationale recently described by Bielefeld, Higginson, Jackson and Ricketts:

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

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<sup>50</sup> “Directors’ “Wider” Responsibilities – Problems Conceptual, Practical and Procedural” (1987) 13 *Monash University Law Review* 164 at p 176.

<sup>51</sup> s 180 Care and diligence

<sup>52</sup> (1995) 16 ACSR 607 at 654 per Clarke and Sheller JJA.

<sup>53</sup> A consistent view is expressed by the CAMAC: *The Social Responsibility of Corporations* (2006) at p 113.

and further;

“The point that is being made - - - is that in addition to any such obligations in the environmental statute, the Corporations Act (together with the common law) also contains remedies and penalties when directors fail in their duty to ensure corporate compliance with an environmental law”.<sup>54</sup>

It is perhaps fair to observe that the matter at issue in the case cited<sup>55</sup> by the authors – a failure to follow authorised practices related to investments that were in breach of the law - is remote from either social or environmental law. As such, pending a more direct judicial testing, a limited number of related incremental developments might, as an alternative, result in a clearer recognition of a link between a breach of environmental law and a breach of a duty owed to the company, or conversely, ensuring directors’ actions, aimed at environmental protection and wider stakeholder interests within the evolving understanding of the company’s interests, are protected.

A further element of contentiousness in understanding the interaction of the law of directors’ duties and environmental and social law is the possibility that there may arise a ‘rational’ decision to deliberately be in breach where the gains outweigh the magnitude of the penalties. We suggest that this is more than a matter of mere speculation, particularly where it involves choice of location decisions influenced by a particular jurisdiction’s comparatively weaker environmental laws. This conundrum is all the more apparent when considered in the further context of the use of the law of member remedies (see 2.3 below) as a possible basis for compelling director behaviour.

### **2.2.9 The business judgement rule**

A form of ‘safe haven’ protection has been introduced into the Australian scheme of directors’ duties. The Corporations Law Economic Reform Program in its 1997 Proposal Paper No 3 (5.2.2) referred to the need to seek a balance between responsible risk taking, accountability to shareholders and the reluctance of courts to

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<sup>54</sup> S. Bielefeld, S. Higginson, J. Jackson and A. Ricketts, “Directors Duties to the Company and Minority Shareholder Environmental Activism” (2004) 23 *Company & Securities Law Journal* 28 at p 36.

<sup>55</sup> *ASIC v Adler* (2002) 41 ACSR 72.

review bona fide business decisions. The latter point is illustrated in judicial comments such as:

“ - - - they (their Lordships) accept that it would be wrong for the court to substitute its opinion for that of management - - - . There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.”<sup>56</sup>

The objective in codifying this general law principle has been to protect legitimate business risk type decisions from judicial scrutiny and thus challenge by shareholders. The statutory form sits appropriately in direct relationship with duties of care and diligence (by inference also skill) as these are the attributes that most directly relate to the management of the company. However when applied to ss 182 and 183 (and their criminal law counterparts in s 184) aspects of fiduciary relationship to which the courts take a far more critical approach, are being dealt with.

To allow some form of business decision-based relief in these latter areas could run counter to long established notions that preclude taking corporate advantage. Nonetheless, it can be suggested that there may be some scope to extend this form of ‘safe haven’ relief to matters potentially dealt with under s 181(1)(a)<sup>57</sup>, particularly given some similarity in wording.<sup>58</sup>

Development of this type may provide a valuable adjunct to the notion of “interests of the company as a whole” in which there is scope for a targeted regard of wider stakeholder interests consistent with the objective of preserving the ongoing viability of the company for future members.

### **2.3 Flexibility and adaptability of members’ remedies**

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<sup>56</sup> *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 834 per Lord Wilberforce.

<sup>57</sup> Though not s 181(1)(b) as courts have typically dealt strictly with aspects of ‘proper purpose’.

<sup>58</sup> Section 180(2)(d) operating as one of the qualifiers on the business judgement protection requires the director or officer to “rationally believe that the judgement is in the best interests of the corporation”.

Given the division of corporate powers, it is also appropriate to give some consideration to the implications that may arise out of the limited, though targeted, basis upon which shareholders are able to challenge the decisions of directors.<sup>59</sup>

Here again there is perhaps potential merit in incrementally based development of the oppressive conduct remedy (s 232 of Part 2F.1). Subsection (d) provides a basis upon the application of a member<sup>60</sup> for the court to make orders<sup>61</sup> where the conduct or omission on behalf of the company is “contrary to the interests of the members as a whole”. Development in this direction could protect the directors from undue or disruptive challenge to decisions made within a widened ambit of “interests of the company as a whole”. Such development would leave unaltered the application of the further ‘limb’ of s 232; that dealing with acts and omissions which are ‘oppressive’, ‘prejudicial’ or ‘discriminatory’ against members.<sup>62</sup>

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

“In balancing the interests the court comes close to determining the merits of a board decision. That is something courts have traditionally refrained from doing when the decision is a commercial one. Courts have expressed support for a similar approach in applying the oppression section”.<sup>63</sup>

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

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<sup>59</sup> Notwithstanding members’ opportunity to ask questions and make comment on the management of the company as a whole at annual general meetings (s 250S), “It is no part of the function of the members of a company in general meeting by resolution, ie as a formal act of the company, to express an opinion as to how a power vested by the constitution of the company in some other body or person ought to be exercised by that other body or person” *NRMA v Parker* (1986) 4 ACLC 609 at 614.

<sup>60</sup> section 234

<sup>61</sup> section 233

<sup>62</sup> section 232(e)

<sup>63</sup> H.A.J. Ford, R.P. Austin and I.M. Ramsay, *Ford’s Principles of Corporations Law* (11<sup>th</sup> ed., Butterworths, 2003) [11.450].

For completeness it is appropriate to consider the converse perspective - that of the capacity for approval of such initiatives, were the law as it relates to the ambit of business judgement not to evolve as envisaged in the above discussion. Again, the law currently provides scope for such accommodation without the need for legislative intervention. Such decisions on the part of directors would prima facie be contraventions of s 180<sup>64</sup> or the 'best interests of the corporation' limb of s 181<sup>65</sup> and may, it is suggested, be open to member ratification. Such powers reserved to the members in general meeting are relatively wide:

“The consequence of these limitations on the scope of ratification should not be overstated. Provided there has been full and frank disclosure of the nature of any particular breach and of the fact that absolution is being sought for that breach, a wide scope remains for valid ratification”.<sup>66</sup>

Moreover, the operation of s 1318 (Power to grant relief) may provide a further level of comfort for directors.

The above discussion deals exclusively with directors' actions and their interaction with members. As with a duty owed to creditors, recognition of a direct actionable duty under the corporations law owed to other stakeholders seems neither practical or desirable.<sup>67</sup> This should preclude any contemplated amendment to Part 2F.1 and Part 2F.1A<sup>68</sup> to accommodate these groups. Interestingly, Bielefeld et. al. do however advance the idea of the derivative action being applied to give *locus standi* to members to accommodate instances where the corporate controllers, as the wrongdoers, may be “inclined to dismiss environmental breaches as part of the cost of doing business”.<sup>69</sup> Adaptation of minority shareholder protections in this manner, though valid, would seem perhaps at best a useful adjunct to rigorous enforcement of

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<sup>64</sup> Care and diligence

<sup>65</sup> Good faith

<sup>66</sup> *Miller v Miller* (1995) 16 ACSR 73 at 89 per Santow J, the 'limitation' on ratification referred to by his Honour relate to fraud on the minority, misappropriation of company resources, insolvent trading transactions or decisions to defeat a member's personal right.

<sup>67</sup> Similarly, the PJC concluded that “the Corporations Act 2001 permits directors to have regard for the interests of stakeholders other than shareholders” and that “amendment to the directors' duties provisions within the Corporations Act is not required”, *Corporate Responsibility: Managing Risk and Creating Value* (Commonwealth of Australia, 2006), para. 4.78.

<sup>68</sup> Proceedings on behalf of a company by members and others

<sup>69</sup> S. Bielefeld, S. Higginson, J. Jackson and A. Ricketts, “Directors Duties to the Company and Minority Shareholder Environmental Activism” (2004) 23 *Company & Securities Law Journal* 28 at p 40.

environmental laws themselves. Similarly, the notion of resort to the courts' injunctive powers under s 1324, again discussed by Bielefeld et. al.<sup>70</sup>, whilst prima facie offering a further corporate law-based avenue for members (and perhaps even third-parties<sup>71</sup>) to compel responsible environmental behaviour, likewise needs to be considered in terms of an appropriate dichotomy between particular branches of the law - certainty and predictability are best served through enforcement of appropriately targeted laws.

#### **2.4 How the law of directors' and officers' might evolve - some practical issues for consideration**

The controversial and problematic aspects of the development of both the business judgement rule and member remedies is highlighted in the following statement from Ms Meredith Hellicar, James Hardie Group's Chairperson made in the context of an assertion of an inability to make provision for future unascertained asbestos-related disease claimants:

"I think protection [for the directors seeking to act in the interests of stakeholders other than shareholders] would be beneficial because there is no doubt that the threat of a shareholder suit – even if we get majority shareholder support – a minority shareholder can still say, we don't agree, so some protection would help ... it certainly might make us feel more comfortable."<sup>72</sup>

This argument is all the more contentious when considered in the light the Jackson QC Report, two brief quotes from which are included as an appendix to this paper.

Turning to the type of minority member activism contemplated by Bielefeld et. al., it is perhaps useful to draw comparison with the law and rules that have evolved in relation to the requisitioning of members' meetings and their interaction with matters

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<sup>70</sup> Ibid, at p 42.

<sup>71</sup> See for example *Airpeak v Jetstream* (1997) 23 ACSR 715 where Einfeld J at 721 concluded that a creditor may have "a sufficient interest" to establish standing for the grant of an injunction in relation to breach of precursor legislation to the current s 180 duty of care and diligence.

<sup>72</sup> F. Buffini, 'Calls to Protect Corporate Conscience', *Australian Financial Review*, 23 November 2005, at p 4.

of management vested in the directors. Section 249N<sup>73</sup>, similar to other sections within Part 2G.2<sup>74</sup>, cannot be used to demand that a motion be put to a members' meeting if the subject is a matter of management.<sup>75</sup> The authors of Ford's whilst recognising the importance of these provisions as a basis for giving effect to the legitimate interest of members, nonetheless regard that in the balance it is highly appropriate to protect directors' powers from erosion.

## 2.5 Directors' duties and corporate social responsibility in New Zealand

The Companies Act 1993, effective from 1 April 1994, provides the legislative source of law relating to directors' duties in New Zealand. It is unclear whether the legislation supplements or replaces the common law and equitable principles in place at the time of its enactment<sup>76</sup>, whereas in Australia the legislative provisions are clearly stated as supplementary to the general law rules.<sup>77</sup> The Companies Act stipulates the following duties of directors:

- To act in good faith and in what the director believes to be the best interests of the company when exercising powers or performing duties (s 131(1));
- To exercise a power for a proper purpose (s 133); and
- To exercise care, diligence and skill (s 137).

Central to the issue of whether the Companies Act promotes or impedes consideration of a broad range of stakeholder interests is the interpretation placed on 'the company', in whose best interests directors must exercise powers pursuant to s 131. The New Zealand courts have not, to date, been required to consider the meaning of 'the company' in the context of s 131.<sup>78</sup> Some guidance, albeit not authoritative in a judicial sense, is provided by the statement by the New Zealand

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<sup>73</sup> Members resolutions

<sup>74</sup> Meetings of members of companies

<sup>75</sup> H.A.J. Ford, R.P. Austin and I.M. Ramsay, *Ford's Principles of Corporations Law* (12<sup>th</sup> ed., Butterworths, 2003) [7.123].

<sup>76</sup> T. Keeper, "Hard Decisions about Soft Law – Or Soft Decisions about Hard Questions: A Discussion of the Laws in New Zealand Regulating in whose (Best) Interest Directors Must Act", Corporate Law Teachers Association Conference, Brisbane 2006, p. 3, citing N. Campbell, "Editorial: Does the Companies Act Codify Remedies?" (2001) NZBLQ, pp. 53-4, and *Manakau City Council v Lawson* (2001) 1 NZLR 599, per Morris J., in an interim decision, and obiter comment in *Benton v Priore* (2003) 1 NZLR 546, at para. 46, per Heath J.

<sup>77</sup> section 185

<sup>78</sup> T. Keeper, "Hard Decisions about Soft Law – Or Soft Decisions about Hard Questions: A Discussion of the Laws in New Zealand Regulating in whose (Best) Interest Directors Must Act", Corporate Law Teachers Association Conference, Brisbane 2006, at p 5.



Law Commission that a reference to the company is a reference to the enterprise itself, as distinct from its shareholders, in *Company Law: Report and Restatement*, which was issued by the New Zealand Law Commission in 1989 and contained the first draft of the bill that subsequently became the Companies Act. Commenting on that statement, Hugh Rennie and Peter Watts, at a New Zealand Law Society Seminar in 1996, argue that the identification of ‘the company’ with the enterprise refers to the long-term profitability of the company.<sup>79</sup> Trish Keeper concludes, based on a review of published texts in the context of s 131 that “subsequent commentators have limited their discussions on the meaning of ‘the company’ to considering the need for boards to consider the interests of different types of shareholders, rather than any other stakeholders”.<sup>80</sup>

Other duties prescribed by the New Zealand Companies Act, reckless trading (s 135) and agreeing to the company incurring certain obligations (s 136), together with ss 131, 133 and 137, are explicitly referred to as duties of directors to the company, as distinct from duties to shareholders (s 169). While the Act does not impose a direct duty to creditors, some regard for this constituency appears to be embraced within the duties to the company. In this regard, the position of unsecured creditors in New Zealand is similar to that in Australia, as discussed above at 2.2.3 and, most specifically with respect to the decisions in *Spies v The Queen* and *Walker v Wimborne* (1976).

The only instance in which the New Zealand Companies Act explicitly provides for consideration of stakeholders other than shareholders or the company, in the context of directors’ duties, is with regard to employees in the limited circumstances referred to in s 132:

“1) Nothing in section [131](#) of this Act limits the power of a director to make provision for the benefit of employees of the company in connection with the company ceasing to carry on the whole or part of its business.

(2) In subsection [\(1\)](#) of this section,—

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<sup>79</sup> Cited in T. Keeper, “Hard Decisions about Soft Law – Or Soft Decisions about Hard Questions: A Discussion of the Laws in New Zealand Regulating in whose (Best) Interest Directors Must Act”, Corporate Law Teachers Association Conference, Brisbane 2006, at pp 4-5.

<sup>80</sup> T. Keeper, “Hard Decisions about Soft Law – Or Soft Decisions about Hard Questions: A Discussion of the Laws in New Zealand Regulating in whose (Best) Interest Directors Must Act”, Corporate Law Teachers Association Conference, Brisbane 2006, at p 5.

“**Employees**” includes former employees and the dependants of employees or former employees; but does not include an employee or former employee who is or was a director of the company.”

To complete our comparison of the law of directors’ duties in Australian and New Zealand we now consider the managerial function and whether potential action by members may deter consideration of the interests of stakeholders other than shareholders in management decision making. The Companies Act provides for review of management by shareholders. This is achieved through several processes including the requirement to “allow a reasonable opportunity for shareholders at the meeting to question, discuss, or comment on the management of the company”<sup>81</sup>. While s 109 (2) permits shareholders to pass a resolution relating to the management of a company, unless the company constitution provides otherwise, “a resolution passed pursuant to subsection [\(2\)](#) of this section is not binding on the board”<sup>82</sup>.

It is also appropriate to consider the circumstances in which shareholders are able to challenge the decisions of directors, beyond the opportunity for comment and non-binding resolutions in meetings referred to in s 109, and whether such powers vested in members provide a means for effecting or impeding consideration of broader stakeholder interests in management decision making. While the Companies Act enables shareholders to bring an action against a director, that capacity is specifically confined to a “breach of a duty owed to him or her as a shareholder”<sup>83</sup>. The Act distinguishes between duties owed to shareholders (s 90 to supervise the share register, s 140 to disclose interests and s 148 to disclose share dealings) and those owed to the company (ss 131, 133, 135, 136 and 137, which are described above, and s 145 relating to the use of company information). In the context of directors’ duties, the scope to consider broader stakeholder interests potentially falls within the duty under s 131 to “act in good faith and in what the director believes to be the best interests of the company”, where the broader stakeholder interests are subsumed within objectives of long-term profitability. We conclude that management decisions that reflect consideration of broader stakeholder interests would be protected from

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<sup>81</sup> section 109 (1).

<sup>82</sup> section 109 (4).

<sup>83</sup> section 169 (1).

unreasonable member challenge under s 169 because the duty under s 131 is a duty to the company, as distinct from its shareholders.

### **3. Corporate social responsibility: can it be mandated?**

#### **3.1 Constraints on directors' and corporate behaviour: internal affairs and external interests**

The notion of a 'threat of constraint', introduced above at 2.1.1, provides a useful perspective on determining where within the broad scheme of the law particular relationships or emerging ills and abuse are best addressed. Moreover, this perspective emphasises the imperative of cohesion and consistency both within the corporations law and in its interaction with other branches of the law.

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

“ - - - managers, freed from legal constraints, can abuse shareholders' interests without cost. Corporation law, according to this view, plays a pre-eminent role in maintaining balance in the large corporation characterised by separation of ownership and control”.<sup>84</sup>

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

Additionally, this perspective reinforces an understanding of corporate law as primarily concerned with government regulation of the internal affairs of the corporations it allowed to be created. Returning to the comments of Professor Sealy, external interests, such as the environment and wider social aspirations, are best

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<sup>84</sup> H. Butler, "The Contractual Theory of the Corporation" (1988-1989) 11 *Geo. Mason University Law Review* 99 at p 102.

served through “positive legislation extraneous to company law” to which the corporation is subject. If these ‘extraneous laws’ are deficient in meeting evolving societal expectations, the primary avenue for redress should be through direct amendment or harmonisation of these laws, rather than adapting to an inconsistent or foreign purpose corporations laws which have evolved to meet fundamentally different needs.

### 3.2 Voluntary vs mandated approaches

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

“ - - - if corporations cannot accept responsibility for the consequences of their actions and decisions, then they will increasingly be obliged to play by rules that are progressively imposed upon them”.<sup>85</sup>

The critical question is whether corporate social responsibility and stakeholder engagement are types of behaviour that lend themselves to highly prescriptive regulation or a more principle-based set of solutions potentially expressed in guidance with a level of legislative weight.

Dealing with political theories of corporate social responsibility and with the strategic dimension to sustainable development respectively Engel alludes to this complexity:

- “It seems - - - that the basic question of corporate social responsibility is not whether we wish to compel or forbid certain kinds of corporate conduct by legislative command - - - but rather whether it is socially desirable for corporations organised for profit voluntarily to identify and pursue social

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<sup>85</sup> R. Sarre, “Responding to Corporate Collapse: Is there a Role for Corporate Social Responsibility?” (2002) 7(1) *Deakin Law Review* 1 at p 13.

ends where the pursuit conflicts with the presumptive shareholder desire to maximise profit”.<sup>86</sup>

and further;

“The social and economic desirability of these two subspecies of corporate voluntarism - disclosure, and abstention from interference with lawmaking – is an extremely complicated question and, again, **the answer may vary with different types of disclosure and different types of interference with lawmaking**”.<sup>87</sup> (emphasis added)

- “ - - - sustainability development practices are a sub-set of business practice engaged in to achieve sound strategy and performance outcomes. **There is no single set of sustainable development practices because every firm has a unique business strategy**”.<sup>88</sup> (emphasis added)

Common to these perspectives is the notion of linkages between stakeholder engagement and the role of information by which the interests of third parties are balanced with those of the company as part of decision-making processes within the context of corporate responsibility. Engel goes on to describes the circumstances that prevailed in the late 1970s, of which a number of observations<sup>89</sup> regarding disclosure are still highly pertinent:

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

It is reasonable to assert that these problems can to a substantial degree be progressively redressed within the various non-financial information reporting

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<sup>86</sup> D.L. Engel, “An Approach to Corporate Social Responsibility” (1979 - 1980) 32 *Stanford Law Review* 1 at p 3.

<sup>87</sup> *Ibid*, at p 5.

<sup>88</sup> “Sustainable Development and Business Success: Reaching beyond the rhetoric to superior performance”, Foundation for Sustainable Economic Development University of Melbourne, March 2005 at p 7.

frameworks, such as the Global Reporting Initiative, that have emerged and which will continue to evolve.<sup>90</sup> Nonetheless, these practices are still in a state of relative infancy, particularly when compared with the formality of financial reporting. Moreover, there is currently no satisfactory framework for gauging the information/decision value of these disclosures amongst recipients. In concluding on whether the Corporations Act should require companies to report on social and environmental impacts of their activities, the CAMAC cautioned:

“It would be premature and counterproductive to introduce detailed legislative social and environmental reporting requirements, given that the form and content of non-financial disclosures are still evolving, internationally as well as locally.”<sup>91</sup>

#### **4. The role of performance disclosure in the recognition of third-party interests**

Developing further the theme of building awareness of third-party interests, two avenues are identified by Parkinson:<sup>92</sup>

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

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

“the mere fact of being under a duty to disclose information is not in itself a reason for companies to change their behaviour”.<sup>93</sup>

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<sup>89</sup> D.L. Engel, “An Approach to Corporate Social Responsibility” (1979 - 1980) 32 *Stanford Law Review* 1 at p 81.

<sup>90</sup> Version three (G3) of the GRI guidelines was released in October 2006.

<sup>91</sup> *The Social Responsibility of Corporations* (2006) at pp 145-6.

<sup>92</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) at p 346.

A range of benefits<sup>94</sup> of responsible corporate behaviour flow from strengthening competency to collect and analyse information about the impact of business operations on third parties:

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

Parkinson goes on to present a number of plausible arguments in favour of an obligation to disclose;<sup>95</sup> the key rationale being that the discipline necessitates collection - the improved information flows thus causing management to limit avoidable damage to third parties. The recognition of what is termed 'social monitoring'<sup>96</sup>, which alludes to a widening array of formal and informal groups which interpret and critique information disclosed in the public domain, is also significant.

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

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

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<sup>93</sup> Ibid, at p 372.

<sup>94</sup> Ibid, at pp 368-369.

<sup>95</sup> Ibid, at p 373.

<sup>96</sup> Ibid, at p 373. Development in this area has been significant with the emergence of, for example, a specific CSR category within the Australasian Reporting Awards and establishment of rating type approaches such as REPUTEX.

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

“For businesses that have very little willingness to be responsible to start with, legalistic command-and-control regulation invites evasion through loopholes and ‘creative compliance’. Overtly technical rules can also increase non-compliance by encouraging evasion and creative adaptation.”<sup>97</sup>

## **5. Regulatory developments in corporate social responsibility disclosures**

Regulatory developments in corporate social responsibility (CSR), or triple bottom line, reporting in Australia reflect both mandatory and voluntary approaches. Developments in New Zealand have, to date, adopted a voluntary approach with respect to private sector reporting requirements but there is evidence of preference, at least among some key players, for prescriptive and mandatory requirements in the longer term. The discussion that follows describes regulatory developments in each country and some examples of voluntary initiatives that have ensued.<sup>98</sup>

### **5.1 Regulatory developments in CSR reporting in Australia**

The most broadly applicable mandatory requirement for public disclosure of environmental performance is prescribed by s 299(1)(f) of the Corporations Act, which requires disclosure in the Directors’ Report of performance in relation to any applicable significant environmental regulations under a law of the Commonwealth, a State or a Territory. Practice Note 68, issued by the ASIC subsequently clarified the requirements of s 299(1)(f), along with other accounting-related amendments that had been introduced into corporate law. In relation to s 299(1)(f) Practice Note 68 states that:

<sup>97</sup> C. Parker, *The Open Corporation: Self-regulation and Democracy* (CUP 2002) at p 10.

<sup>98</sup> For a review of regulatory developments and professional initiatives in sustainability reporting in the Asia Pacific region, refer to S Jones, G Frost, J Loftus and S Van Der Laan, *Sustainability Reporting: Perspectives on Regulatory and Professional Initiatives across the Asia Pacific*, (CPA Australia 2005), [http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FEDF-D3348499/cpa/hs.xml/14131\\_17446\\_ENA\\_HTML.htm](http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FEDF-D3348499/cpa/hs.xml/14131_17446_ENA_HTML.htm) accessed 10/1/2007.



“a) Prima facie, the requirements would normally apply where an entity is licensed or otherwise subject to conditions for the purposes of environmental legislation or regulation.

b) The requirements are not related specifically to financial disclosures (eg. contingent liabilities and capital commitments) but relate to performance in relation to environmental regulation. Hence, accounting concepts of materiality in financial statements are not applicable.

c) The information provided in the directors’ report cannot be reduced or eliminated because information has been provided to a regulatory authority for the purposes of any environmental legislation.

d) The information provided in the directors’ report would normally be more general and less technical than information which an entity is required to provide in any compliance reports to an environmental regulator.”

Another mandatory, but less widely applicable, disclosure requirement is specified by the Financial Services Reform Act 2001, which requires product disclosure statements (PDSs); entities that provide financial products with an investment component are required under s 1013D(1)(1) to disclose the extent to which labour standards or environmental, social or ethical matters are considered in investment decisions. The disclosure requirement is supplemented by *Section 1013DA Disclosure Guidelines*<sup>99</sup> issued by the ASIC in 2003. The approach adopted by the ASIC in the *Guidelines* is to compel responsible decision making by mandating information flows rather than to attempt to prescribe how labour standards, or environmental, social or ethical matters should be taken into consideration, as indicated in the following introductory statement:

“These guidelines do not set out what constitutes a labour standard or an environmental, social or ethical consideration, or what methodology product issuers should use for taking these issues into account. The guidelines do, however, make it clear that you must disclose *which* of these standards and considerations you take into account and *how*. If you have no predetermined approach, then this too must be clear. The more a product is

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<sup>99</sup> *Section 1013DA Disclosure Guidelines* are mandatory for issuers of product disclosure statements.

marketed on the basis that such standards and considerations are taken into account, the more detail is required.”<sup>100</sup>

A further regulatory development, reflecting a voluntary approach<sup>101</sup>, is the reference to a broader set of stakeholders in the *Principles of Good Corporate Governance and Best Practice Recommendations* issued by the ASX Corporate Governance Council in March 2003, “Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders”.<sup>102</sup> The accompanying preamble to Principle 10<sup>103</sup> acknowledges the growing acceptance of consideration of environmental and social challenges and opportunities as a source of business success:

“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. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices.”

Rather than the prescriptive approach employed in the U.S.<sup>104</sup>, the ASX in its corporate governance reforms adopted a “comply or explain” approach, supported by disclosure requirements, leaving assessment of what constitutes appropriate objectives, policies and governance mechanisms to market participants and other

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<sup>100</sup> ASIC (2003) *Section 1013DA Disclosure Guidelines*, at p 3.

<sup>101</sup> The approach is not strictly voluntary, to the extent that specific disclosure is required. Peter Wallace and John Zinkin, in *Mastering Business in Asia: Corporate Governance* Wiley, 2005, at p 339 describe the “balanced”, or “hybrid” approach to corporate governance reform as drawing on both prescriptive and non-prescriptive approaches by providing leading practice guidelines and requiring a “comply or explain” reporting style.

<sup>102</sup> Recommendation 10

<sup>103</sup> The ASX Corporate Governance Council has since proposed a redistribution of Principle 10 across Principles 3 and 7, such that the material concerned with codes of conduct would be incorporated in Principle 3, to promote ethical and responsible decision making, and the material concerned with addressing the concerns of a wider set of stakeholders would form part of Principle 7, to recognise and manage risk, *Review of the Principles of Good Corporate Governance and Best Practice Recommendations and Consultation Paper* (November 2006) at p 10,

[http://www.asx.com.au/supervision/governance/principles\\_good\\_corporate\\_governance.htm](http://www.asx.com.au/supervision/governance/principles_good_corporate_governance.htm) accessed 10/1/2007.

<sup>104</sup> Sarbanes-Oxley Act 2002

stakeholders. A study of compliance in 2004 with corporate governance reporting requirements and best practice recommendations of the top 500 listed entities found less than 60% compliance with recommendation 10, compared with average compliance rates of 68% across all principles.<sup>105</sup> A study of users of corporate governance disclosures, comprising shareholders and financial and other professional advisers, found that while all corporate governance items were considered important, 49% of respondents were interested in information about shareholder/stakeholder management, which ranked fifth behind corporate governance disclosures about financial reporting, board structure/responsibilities, remuneration and risk management; and information about social and environmental impacts and accountability combined with information about directors and management (other than board structure/responsibilities and remuneration) were identified as of interest by 5% of respondents.<sup>106</sup>

More recently consideration has been given to the appropriateness of the ASX Corporate Governance Council's potential consideration of sustainability / corporate responsibility reporting.<sup>107</sup> The PJC has recommended that the ASX Corporate Governance Council provide further guidance in relation to Principle 7 of the *ASX Principles of Good Corporate Governance and Best Practice Recommendations* "to the effect that companies should inform investors of the material non-financial aspects of a company's risk profile by disclosing their top five sustainability risks (unless they demonstrate having fewer); and providing information on the strategies to manage such risks".<sup>108</sup>

## 5.2 Regulatory developments in CSR reporting in New Zealand

Reference to consideration of stakeholders other than shareholders is made in *Corporate Governance in New Zealand: Principles and Guidelines*, issued in February 2004 by the Securities Commission, which regulates corporations in New Zealand. Principle 1 states that issuers should "adopt, observe and foster high

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<sup>105</sup> Australian Stock Exchange, (2005), *Analysis of Corporate Governance Practices Reported in 2004 Annual Reports*.

<sup>106</sup> ASX, *Corporate Governance (Market Research Project): Key Highlights*, March 2006, at p 4.

<sup>107</sup> ASX Corporate Governance Council *Review of the Principles of Good Corporate Governance and Best Practice Recommendations and Consultation Paper* (November 2006) Part B.

<sup>108</sup> PJC *Corporate Responsibility: Managing Risk and Creating Potential* (2006) Recommendation 10.

ethical standards”<sup>109</sup>. The guidelines elaborate on this principle to suggest that the board should adopt a written code of ethics, addressing matters including “fair dealing with customers, clients, employees, suppliers, competitors, and other stakeholders”<sup>110</sup>. Moreover, principle nine states that the board “should respect the interests of stakeholders within the context of the entity’s ownership type and its fundamental purpose”.<sup>111</sup> The guidelines expand on the principle to indicate that boards “should have clear policies for the entity’s relationship with significant stakeholders, bearing in mind distinctions between public, private and crown ownership”<sup>112</sup>; and that compliance with these policies should be regularly assessed to ensure that “conduct towards stakeholders complies with the code of ethics and the law and is within broadly accepted social, environmental, and ethical norms, generally subject to the interests of shareholders”.<sup>113</sup> The Securities Commission describes stakeholders as including employees, customers, creditors, suppliers, the community and others, and notes that “advancing the interests of other stakeholders such as employees and customers will often further the interests of an entity and its shareholders”.<sup>114</sup>

While requiring public sector entities to report publicly on “their activities and performance, including on how they have served the interests of their stakeholders”<sup>115</sup>, the Securities Commission does not specify corresponding disclosure requirements for private sector corporations; instead relying on the requirement in the New Zealand Stock Exchange (NZX) Listing Rules: Listed entities are required to include in their annual reports “a statement of any corporate governance policies, practices and processes”<sup>116</sup> and “whether and, if so, how the corporate governance principles adopted or followed by the Issuer materially differ from the Corporate Governance Best Practice Code or a clear reference to where such statement may be found on the Issuer’s public website”<sup>117</sup>. The disclosure requirements are not prescriptive, instead leaving decisions on the scope and level of detail to be determined by market participants. The majority of respondents to the

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<sup>109</sup> Securities Commission, (2004), *Corporate Governance in New Zealand: Principles and Guidelines*.

<sup>110</sup> *Ibid.*, at 1.1.

<sup>111</sup> *Ibid.*, at 9.

<sup>112</sup> *Ibid.*, at 9.1.

<sup>113</sup> *Ibid.*, at 9.2.

<sup>114</sup> *Ibid.*, refer Principle 9 Stakeholder Interests - “Securities Commission view”.

<sup>115</sup> *Ibid.*, at 9.3.

<sup>116</sup> Rule 10.5.3(h).

<sup>117</sup> Rule 10.5.3(i).

consultation process preceding the release of the Securities Commission's *Corporate Governance in New Zealand: Principles and Guidelines* maintained that stakeholder considerations and disclosures pertaining to stakeholder considerations should be at the discretion of the board.<sup>118</sup> It should be noted that the disclosure requirements pertain to policies, practices and processes, but do not explicitly extend to outcomes and performance. Further, unlike the ASX *Principles of Good Corporate Governance and Best Practice Recommendations*, the NZX *Corporate Governance Best Practice Code* makes no mention of policies for consideration of the concerns for stakeholders other than shareholders.<sup>119</sup>

As part of a long term development, the Sustainable Development Reporting Committee (SDRC) was established in 2003 following the recommendations of the Institute of Chartered Accountants of New Zealand's (ICANZ) [Taskforce on Sustainable Development Reporting](#) in 2002. The SDRC is accountable to the Financial Reporting Standards Board (FRSB) of the Institute, but operates as a stand-alone committee. The terms of reference for the SDRC are to "provide on-going leadership and guidance on the external reporting and auditing of sustainable development reporting, with the intention of integrating the reporting and auditing of economic, social and environmental measurement within the activities of the FRSB by 31 December 2005".<sup>120</sup> During 2004 the SDRC was put on hold due to other priorities of the ICANZ and the terms of reference were extended to 31 December 2006.

While the SDRC Committee is yet to report against its terms of reference, recommendations consistent with the view that sustainability reporting should be neither mandatory nor prescriptive, at least in the short term, are expressed in its submission on the FRSB's ED: NZ Framework<sup>121</sup> (emphasis added):

"We would much prefer a framework which **facilitates voluntary reporting of SDR matters** by entities in all sectors."

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<sup>118</sup> T. Keeper, Hard Decisions about Soft Law – Or soft decisions about hard questions, Corporate Law Teachers Association Conference, Brisbane 2006.

<sup>119</sup> The *Corporate Governance Best Practice Code* issued by the NZX includes corporate governance principles pertaining to corporate ethics, directors, committees (audit, remuneration and nomination), auditors and reporting.

<sup>120</sup> <http://www.icanz.co.nz> accessed 10/1/2007.

<sup>121</sup> Sustainable Development Reporting Committee, (2004), *A Submission by the Sustainable Development Reporting Committee, Exposure Draft: New Zealand Framework*, 6 August, at pp 3-4.

And further,

“The accountability regime for external reporting is too narrow and needs to be (i) widened to include a range of stakeholders, all of whom have a wider range of information needs and (ii) updated to reflect the increased expectations of stakeholders. SDR places an onus on reporters to **engage with stakeholders to identify their information needs**, hence the section on ‘Users and Their Information Needs’ should be comprehensive.”

The SDRC’s reluctance to support a prescriptive approach to sustainability reporting requirements reflects concerns about the reporting capacity in the short term as indicated by the Committee’s response on “whether there are any issues arising from the proposed NZ Framework that you consider the FRSB should raise with the IASB”<sup>122</sup>:

“The SDRC suggest that the FRSB should consider sending a remit to the IASB, requesting ...

(ii) The IASB to consider preparing voluntary best practice guidelines for Non-Financial Information and/or Sustainable Development Reports. It is envisaged that the guideline would remain voluntary and principle based in the short term to enable innovative and research-based decisions and operating practice to occur. In the medium term, the SDRC considers a standard (rule based approach) will be necessary to enhance quality and improve comparability. Without such guidance, legislation will be the only solution to meet the increased demands by users for transparency and verifiability of economic, social and environmental information.”

It should be noted that the views of the SDRC are not necessarily those of the FRSB; it remains to be seen, both in the short term and the medium term, what will be the future direction, both in approach and scope, of regulation of CSR reporting in New Zealand.

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<sup>122</sup> Ibid, p 36.

## 6. Conclusion

Significant amongst the PJC's recommendations, and to which a separate series of Labor Party recommendations concurred and with which the CAMAC recommendations are in agreement, is the conclusion that the present structure and content of the law of directors' duties permits appropriate regard to be given to the interests of stakeholders other than shareholders. As such, whilst no amendments to these provisions in the Corporations Act 2001 are recommended, a number the PJC's observations are noteworthy.

The PJC in Chapter 4 (Directors' Duties) of its report canvasses a range of interpretations that can be applied to the law of directors' duties to determine the contrasting restrictions and permissiveness on directors making decisions from a 'corporate responsibility' perspective. Consequently, the Committee rejects the more narrow or polarised interpretations that rationalise directors' decision making from either a constituency of interest centred on the company itself or a paramountcy of shareholder wealth maximisation, and that moreover there exists no undue impediment based upon the need to satisfy 'interests' primarily in the short term. The Committee concludes by suggesting that the most appropriate interpretation of the scope for accommodating a wider basis of corporate responsibility beyond a primarily short-term company or shareholder orientation afforded by the current structure of the law, is from the perspective of enlightened self-interest. Significantly, a critical feature of this will be in the realm of identifying and applying appropriate bases of stakeholder engagement, acknowledging as such that the way forward in encouraging greater corporate responsibility will primarily be through non-legislative means. In these terms the Committee observes elsewhere in its report the scope of both the ASX corporate governance guidance principles<sup>123</sup> and the evolving development of corporate Operating and Financial Review disclosures<sup>124</sup> as a basis of informing the market and wider stakeholders of non-financial performance. Interestingly, and perhaps somewhat controversially, the Committee has identified a substantial role for company auditors in not only reviewing company Operating and Financial Reviews, but also performing the task of making recommendations to management to enable such reports to achieve greater utility of external assessment of risk management strategies. Additionally, the Committee whilst highly supportive of the development of the GRI, acknowledges the formative nature of non-financial

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<sup>123</sup> Recommendation 10.

<sup>124</sup> Recommendation 8.

reporting thus rejecting any suggestion that it form the basis of an 'endorsed' framework of reporting either at a mandatory or voluntary level.<sup>125</sup> Clearly, whilst the Committee has probably 'laid to rest' any suggestion of wholesale change or reinterpretation of directors' statutory and general law duties, its report nonetheless foreshadows a significant period of upheaval and elevation in the significance of non-financial reporting.

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<sup>125</sup> Recommendation 9.



**Appendix: Extracts from the Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation, D.F. Jackson QC, September 2004**

Terms of Reference 2 of the 'James Hardie Inquiry' is as follows:

“The circumstances in which MRCF (Medical Research and Compensation Foundation) was separated from the James Hardie Group and whether this may have resulted in or contributed to a possible insufficiency of assets to meet its future asbestos-related liabilities.”

The essence of MRCF's position is that it had been established to control two former companies of the James Hardie Group, Amaca Pty Ltd and Amaba Pty Ltd, which had previously been manufacturers of asbestos-based products. These companies thus had, and will continue to acquire, legal liabilities to many yet to be identified persons affected by James Hardie's asbestos products. In his conclusions Jackson QC identifies the motive for the reorganisation, an essential part of which was also the relocation of the Group's control to the Netherlands<sup>126</sup>:

“The principal purpose of separation was to enable the Group thereafter to obtain capital or loan funding or to use its own share capital for future acquisitions without the stigma of possible future asbestos liabilities.”<sup>127</sup>

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<sup>126</sup> JHI NV

<sup>127</sup> 1.6 at p 8.