ARTICLES

WERE CORPORATE TSUNAMI DONATIONS MADE LEGALLY?

Directors and corporate social responsibilities

PETER HENLEY

The question 'what is the social responsibility of companies?' has been asked since the time of *Salomon v Salomon & Co Ltd*.[1] However, some recent events in Australia have refocused public attention on the question. When Australian companies committed to making substantial donations to support relief work for tsunami-affected areas in early January 2005, the Australian Shareholders Association (ASA) questioned whether the decision by directors to make such donations was legal, given the duty of directors to 'act in the best interests of the company's shareholders'.[2] Although a critical public response prompted the ASA to issue a media release stating it did not oppose tsunami donations, the ASA has maintained its position concerning donations in general, at a minimum seeking their full disclosure to shareholders.[3]

On 23 March 2005, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, referred the issue of directors' duties and corporate social responsibility to the Corporations and Markets Advisory Committee ('the CAMAC Referral').[4] CAMAC has been asked to advise whether directors should be permitted or specifically required to take into account the interests of specific stakeholders in a company, and whether the *Corporations Act 2001* (Cth) — specifically its provisions dealing with directors' duties — is the right mechanism to address these issues.

The Parliamentary Joint Committee on Corporations and Financial Services is also currently inquiring into the issue of corporate social responsibility and is due to report by 29 November 2005.

Most recently, the *Sydney Morning Herald* and *The Age* published the second Australian Corporate Responsibility Index.[5] The index assesses the performance of participating companies against a range of social and environmental criteria. Companies were given a percentage score for their performance against each criterion, and an overall ranking based on those scores.

This article considers two questions: What 'socially responsible' acts does the current law permit, or exclude? And what approach to law reform would best mandate the responsibilities of companies, while also providing adequate disclosure to shareholders and certainty to directors?

What is the existing legal duty, and what is its theoretical basis?

Directors' duties derive from a mixture of case law rules and provisions of the *Corporations Act*. The debate about tsunami donations focused on the duty of directors to exercise their powers in good faith in the interests of the company, which now finds its primary expression in s 181(1) of the *Corporations Act*. Section 181 provides:

> A director or other officer of a corporation must exercise their powers and discharge their duties:
>
> (a) in good faith in the best interests of the corporation; and
>
> (b) for a proper purpose.

The generally accepted common law test considers the phrase 'best interests of the company' to mean the interests of the company's shareholders.[6] Later cases, in certain limited contexts relating to insolvency, have also required directors to have regard to a company's creditors to satisfy this test.[7]

In addition, s 181(1)(b) provides that directors must only exercise their powers or discharge their duties for a 'proper purpose'. To fail this test, the substantial purpose of the exercise must have been improper or collateral to the directors' duties, and the court must determine whether, 'but for' that improper or collateral purpose, the directors would have performed that act.[8] Both limbs of the section must be met in any exercise of powers and duties by a director.[9] A breach of these duties can lead to civil penalties under s 181, or to criminal sanction under s 184 if those breaches are committed dishonestly or recklessly.

The test above is supported by both the 'contractual' and the 'managerialist' theories of the corporation.[10] Both maintain that the role of directors in managing the company's operations is to maximise its profits and grow the wealth of its shareholders. In this context, the shareholders' interests are seen as financial interests.[11]

The 'team production' model of the corporation, by contrast, maintains that a broader range of interests are relevant to the wellbeing of a company. It assesses a company's operations by having regard to the team of stakeholders who make essential contributions to a company — including its creditors, employees, executives and the local community — and holds that directors act as a '"mediating hierarchy" ... whose primary function is to exercise ... control in a fashion

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4. Parliamentary Secretary to the Treasurer, Commonwealth of Australia, 'Pearce Announces Integrated Approach to Insolvency Law Reform' (Press Release No 9, 22 March 2005) <http://parlsec.treasurer.gov.au/cjp/content/pressreleases/2005/009.asp> at 31 May 2005.
5. St James Ethics Centre, *Sydney Morning Herald* and *The Age*, '2004 Corporate Responsibility Index', (4 April 2005); Corporate Responsibility Index <www.corporate-responsibility.com.au/default.asp> at 2 August 2005.
6. Harold Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12th ed, 2005) 341.
7. See, eg, *Walker v Wimborne* (1976) 137 CLR 1, 7; Ford, Austin and Ramsay, above n 6, 351.
8. *Kokotovich Constructions Pty Limited v Wallington* (1995) 17 ACSR 478, 490; *Permanent Building Society (in liq) v Wheeler* (1994) ACSR 109, 137.
9. William Heath, 'Directors' Duties and Corporate Governance' (2000) 18 *Company and Securities Law Journal* 377; Ashley Black, 'Officers — Duty of Good Faith under s 181' in *Australian Corporations Law — Principles and Practice* (Vol 1) (2004) 32, 281.
10. Black, above n 9, 25.
11. Therese Wilson, 'The "Best Interests of the Company" and Corporate Social Responsibility' (Paper presented at the Corporations Law Teachers Association Conference, Sydney, 7 February 2005), 2.

The debate about tsunami donations focused on the duty of directors to exercise their powers in good faith in the interests of the company ...

that maximises the *joint welfare of the team as a whole*'.[12]

Although the empirical accuracy and applicability to a broad range of companies of the team production model has been queried,[13] and despite the fact that the law has not endorsed this theory, some companies — particularly listed companies — now publicly state that they employ socially responsible business strategies which are based on the consideration of some or all of the stakeholder interests identified by the team production model. Is this legal?

What 'socially responsible' acts does the law permit?

What is meant by 'corporate social responsibility'?

The term 'corporate social responsibility' is often used unscientifically as an umbrella term for a range of actions or activities which require companies to consider the world around them and their role in it. The terms 'philanthropy', 'sustainability' and 'triple bottom line reporting' are frequently companion terms for 'corporate social responsibility'. However, clumsy or indiscriminate use of the phrase 'corporate social responsibility' runs the serious risk of confusing the debate on legal obligations and constraints on corporations engaging in so-called 'socially responsible' behaviour.

To add substance to the phrase 'corporate social responsibility', some writers distinguish between 'sincere' and 'insincere' socially responsible acts by corporations.[14] 'Sincere' acts involve the voluntary sacrifice of profits by a company, or the incurring of additional costs, 'in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation'.[15] This view equates 'sincere' social responsibility with the definition of 'philanthropy': literally, a 'love of mankind', an approach to practical benevolence in which the doing of something tangible for the good of others carries no expectation of reciprocation or reward. It may also include what are sometimes referred to as acts of 'social activism': acts which generally benefit society, or parts of it, but which occur outside the ordinary scope of a company's operations.[16]

Alternatively, companies which perform 'insincere' acts aim purely to maximise shareholder wealth, improve their reputations and 'hide their true, self-interested natures'.[17] A less extreme version would view such acts as 'relational responsibility', an attempt to promote the welfare of stakeholders whose interests are affected by the company's mainstream business activities, and hence those of the business.[18]

Does motivation matter?

The answer to the question 'are sincere acts of social responsibility illegal under the current law?' is clearly 'yes'. But are these distinctions helpful? An unfortunate consequence of the sincerity–insincerity dichotomy is that it appears to dismiss 'insincere' acts as morally less valuable, through an emotional and moral projection onto what we expect from a good corporate citizen.[19] However, as expressed by Sir Gerard Brennan, it may be that '[f]rom the moral viewpoint, there is no virtue in a directors' resolution to dispose of corporate assets to a charitable object. Virtue consists in giving what is one's own, not in the giving of assets that belong to another'.[20]

Perhaps a more pragmatic view is that, 'sincere' or not, a broad range of socially responsible activities undertaken by companies can have a positive impact on both that company's business and the broader community. Those types of activities should be encouraged. Of course, some companies may insincerely trumpet such programs without honestly and fully implementing them. However, such abuses should not be considered representative, and fear of abuse should not prevent Parliament from seeking to promote such programs.

What socially responsible acts can companies currently do?

What existing programs are run by companies?

Many companies run a variety of community-focused programs which can be justified under the current law.

A generally accepted justification is that such programs produce 'brand goodwill' or other valuable returns to the company. This justification is also used to support corporate sponsorship of sporting events, or advertising in general; value is captured through increased brand or product awareness. Such programs use a standard business model of investment and return, and can be justified by directors as being both in the interests of the company and for a proper purpose.

An alternative justification is that social responsibility programs are part of a broader business case based on 'sustainable' business practices.[21] Sustainability, akin to the team production model, considers a diverse range of stakeholder interests in a company within one

12. Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) *Virginia Law Review* 247, 249–250 and 271.

13. Ford, Austin and Ramsay, above n 6, 29.

14. John Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company* Law (1994), cited in Wilson, above n 11, 3–4.

15. Ibid.

16. Ibid.

17. Wilson, above n 11, 5.

18. Ibid.

19. On the 'citizenship' of corporations, see Suzanne Corcoran, 'The Corporation as Citizen and as Government: Social Responsibility and Corporate Morality' (1997) (2) *Flinders Journal of Law Reform* 53, 55–57.

20. Sir Gerard Brennan, 'Law, Values and Charity' (2002) 76 *Australian Law Journal* 492, 497.

21. See, eg, the companies referred to in Wilson, above n 11, 5–8.

unifying framework. Building on the traditional financial factors used to assess the potential and advantages of a business, sustainability adds social and environmental factors covering a range of considerations, from employees to the communities in which the company has its markets and its recycling practices. By developing sustainable strategies concerning its social and environmental impact, a company aims to operate more efficiently, and hence profitably, through implementing policies and practices directed towards controlling that impact and fostering beneficial social relationships. Reports by companies on these three factors — 'triple bottom line' reports — enable shareholders and the broader community to see how a company is performing on these fronts.

However, sustainable practices need not necessarily be directed towards an holistic net 'best outcome' for the broader community any more than towards producing the greatest return for shareholders. Sustainability is not defined so much by its objective as by its methodology, by *what* it considers should be taken into account, and *how* to do so, in formulating business strategies. Hence, a legitimate business case based on sustainable policies can be justified even under the existing law. For example, the following statement appears on a page headed 'Our Social Responsibility — Our Business Case for Corporate Sustainability' on the Westpac website:

> By adopting sustainable business practices, we believe we will deliver a better outcome for our customers, our staff and the broader community and enhance our reputation. And that's good for our longer term competitive and financial position.

Avoidance of negative publicity, or rebuilding a reputation

Policies which take into account the interests of a broader range of stakeholders can also be used to mitigate the effects of negative publicity and damage to reputation.

For example, James Hardie Industries NV has been criticised for its handling of claims for asbestos-related injuries by former workers.[22] In public statements, the company has recognised the damage this has caused to its reputation, and has adopted and publicised an approach which takes into account the interests of people other than simply its shareholders. In a company statement released on 21 December 2004, Chairman Meredith Hellicar committed herself to 'the task of rebuilding the reputation of James Hardie over the coming months and years for the sake of our many employees, customers, shareholders and other stakeholders'.[23] Further, the main page from the Governance section of its website now also carries the following statement:

> We think it is important that our behaviour reflects the spirit, as well as the letter, of the law and we aim to govern the company in a way that meets appropriate community expectations.[24]

Although the situation of rebuilding a reputation is less desirable than seeking to retain one, it provides a useful example of the potential costs involved in seeking to repair a damaged reputation. Consequently, decisions directed towards maintaining a reputation, particularly to meet specific community expectations, could be seen as producing significant potential cost savings (or risk reduction) and hence fall within the permitted exercise of a director's powers.

However, policies justified as being 'socially responsible' may be adopted cynically or 'insincerely', and be used to simply add perceived credibility to a policy of pure profit maximisation, or for the personal gain of directors. One possible example was suggested in 2002 during the cross-examination of Ray Williams as part of the HIH Royal Commission. Lead counsel Wayne Martin QC questioned Williams about the honorary doctorate of laws from Monash University received by Williams in the context of over $2 million in donations from HIH to various Monash research facilities. Media reports of the issue focused on concepts of insincerity in their descriptions, describing the allegations by suggesting that Williams used HIH money to 'buy himself' an honorary doctorate, and reporting that Martin had put it to Williams that he 'used the funds for [his] own self-aggrandisement'.[25] Williams was reported to have sought to justify these acts by claiming that the donations were expressions of his belief that 'part of corporate philosophy should be that the organisation is a good corporate citizen'.[26]

The Commissioner found 'there were no guidelines in place which established a policy in relation to the making of donations in the interests of the company and its shareholders and how such a policy should be implemented.'[27] Although the Commissioner did not suggest such guidelines should be mandatory, he did indicate they may be part of appropriate corporate governance practices.

Consequently, it could be inferred that such a policy could provide a 'due diligence'-style defence, particularly if that policy had been available for consideration by shareholders. Although this is more a question of good corporate governance than one particularly directed towards the social responsibility of companies, it underlies the concern of the ASA to ensure that, if companies make donations to charitable organisations, those donations should be disclosed to ensure shareholders determine whether they think such donations are appropriate.

Were the tsunami donations legal?

The ASA maintained that a director will only satisfy their duties if the director could properly determine in good faith that the donation was in the 'best interests of the shareholders'.[28] Based on the current test, a donation would only be permissible if it were to produce a financial benefit (or presumably avoid a detriment) for shareholders.

Aside from the moral question of whether companies should assist with tsunami relief, because of the magnitude of the disaster and consequent public attention, and the clear range of benefits companies

22. See, eg, AAP, '20,000 Demand Action from James Hardie', *Sydney Morning Herald* (Sydney), 15 September 2004.

23. Jamie Hardie Industries NV, 'James Hardie Signs Heads of Agreement: Company Statement' (21 December 2004) <www.ir.jameshardie.com.au/default.jsp?xcid=13#2004> at 2 August 2005.

24. 'Governance at James Hardie', Corporate Governance & Disclosure, James Hardie Industries NV, <www.ir.jameshardie.com.au/public/content/default.asp?xcid=60> at 2 August 2005.

25. 'Williams: "I Did Not Deceive"', *The Age* (Melbourne), 7 August 2002.

26. David Elias, 'Williams Good Corporate Citizen but No Doctor', *The Age* (Melbourne), 7 August 2002.

27. *Report of the HIH Royal Commission* (2003), Pt 3, [23.7.9] <www.hihroyalcom.gov.au/finalreport/index.htm> at 2 August 2005.

28. Malcolm Maiden, 'Tsunami: The Backlash', *The Age* (Melbourne), 12 February 2005.

could say they derived from making those donations, it can be forcefully argued that those donations fall within the permissible exercise of existing duties. The factors which may justify these donations include:

- local and international publicity, and consequent increased brand awareness
- workforce motivation, particularly through companies matching employee donations, such as those reportedly made by ANZ and Westpac[29]
- the desire to avoid negative publicity in being seen to shirk social responsibilities other companies had discharged.

Further, there was a high level of community expectation that all parts of society — including companies — would respond on an unusually large scale to the Boxing Day tsunami crisis.

Based on these factors, a strong case can be made that such donations benefited the company, even on the narrow test under s 181, and that directors were therefore acting within their duties to approve the making of those donations.

The CAMAC Referral and some possible approaches to law reform

In the context of the existing law and current practices by Australian companies, the CAMAC Referral asks:

1. Should the *Corporations Act* be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?
2. Should the *Corporations Act* be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?
3. Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?
4. Should the *Corporations Act* require certain types of companies to report on the social and environmental impact of their activities?

The answers to these questions should be: yes, no, yes and yes, for the following reasons.

Should directors be 'required' to consider a broader range of stakeholders?

How might this be done?

One approach, implied perhaps by the language of Referral question 2, would be to list in the *Corporations Act* the specific classes of stakeholders whose interests directors must consider when discharging their duties under s 181. However, how comprehensive should that list be? Would the directors need to consider each of these stakeholders in making every decision, or prioritise them? If not, for what types of decisions would they be required to consider those interests?

In considering the enforceability of the interests of other groups, commentators have pointed to one key difficulty: where a director may be required to consider the interests of people other than shareholders or creditors, it is unclear to whom that duty is owed. Such a duty may be enforceable only by the company as a corporate entity, and not by the shareholders or any other relevant interest holder.[30] The difficulties involved in assessing such competing interests may simply be too great for some companies, and involve too many risks. This may act as a disincentive for directors to consider such practices, particularly in 'grey areas' where the priority of interests may be unclear.

For example, the Corporate Responsibility Bill 2002 (UK), a private member's bill, sought to impose reporting duties on directors regarding the social and environmental impact of a company's operations, and also sought to impose liability on directors for 'significant adverse environmental and social impacts' of those operations, where that impact arose from the negligence or wilful misconduct of directors. However, that bill and a subsequent private member's bill limited to reporting obligations[31] were dropped after their first and second reading speeches respectively — neither was supported by the government, and the former was opposed by organisations such as the British Chambers of Commerce due to a perception it would place a 'huge burden' on small and medium-sized businesses.[32]

A more practical prescriptive model, however, already exists. The law already contains a range of environmental and workplace regulations, trade practices legislation and consumer credit codes, and its scope, or the issues covered by it, can be broadened. By requiring companies to adopt particular social or environmental practices, with penalties attached for failure to adhere to those obligations, the law can require directors to formulate socially responsible company policies in clear and enforceable terms. Rather than relying on the discretion of directors to consider particular issues of social concern, Parliament should take the lead by using its legislative power to set minimum standards of conduct for companies, building on existing laws relating to employment, discrimination, and environmental protection.

Should directors be 'permitted' to consider a broader range of stakeholders?

Alternatively, the law could be amended to provide a permissive explanation of the 'stakeholders' to whom directors may have regard in exercising their duties, particularly those under s 181. This permissive approach could be inserted into the *Corporations Act* interpretative provisions relevant to the phrase 'best interests of the corporation'. A provision could be included to provide that, in determining what is in the best interests of the company for the purposes of s 181(1)(a), a director may have regard to the interests of 'stakeholders'. 'Stakeholders' could be defined as a person or organisation, other than a person or organisation who is a shareholder, with whom the company has or is likely to have a business or employment relationship, or who is or may become *directly* affected by the business of the company. Although the word 'directly' would limit the scope of

29. 'Corporate Australia 'Slow' to Open Its Wallet', *Sydney Morning Herald* (Sydney), 31 December 2004.

30. Ford, Austin and Ramsay, above n 6, 346.

31. *Performance of Companies and Government Departments (Reporting) Bill 2004* (UK).

32. 'UK: MP's Corporate Responsibility Bill would Hit Small Firms', *Sri Media* (United States), 23 June 2003, <www.srimedia.com> at 31 May 2005.

impact that may be considered by a director, this is probably a reasonable way of limiting the potentially vast scope of considering all potentially affected interests.

Despite the fact that Parliament should take the lead in prescribing minimum standards of conduct of social responsibility, adopting a permissive approach would permit companies to exceed any prescribed minimum standards of social responsibility with greater confidence. It may also help to alleviate concerns directors may currently have that some decisions, while made based on a director's assessment that they are in the best interests of the company, may be difficult to prove to be strictly in the best financial interests of the company's shareholders.

Investments as a social issue and the promotion of disclosure

Ownership of a company of course still rests with shareholders, and the directors are elected by them to manage the business better than shareholders realistically can and to produce a return on the shareholder's investment. Particularly in the context of increased privatisation of essential services and the increasing amount of wealth held in superannuation funds and invested in the share market, it would of course be irresponsible to undermine the fundamental rationale for a shareholder to invest in a company by allowing directors to simply give away shareholder money. The security and sustainability of financial investments is consequently a significant social issue in its own right.

Hence, any law reform which expressly extends the range of interests a director may consider must also be consistent with and promote the sound financial management of companies, and the accountability of management through disclosure to shareholders and the public. Some companies already prepare detailed reports on their performance regarding health, safety, environmental practices and interaction with the community,[33] and this practice should be mandated — particularly for listed companies — through enhanced social responsibility reporting requirements in annual reports or through continuous disclosure notices where sufficiently material.

For example; in a white paper entitled 'Modernising Company Law' released in July 2002, the British Department of Trade and Industry spoke of the benefits of narrative reporting on a company's operations in addition to its financial performance, given the 'wide range of factors within and outside the company which are relevant to achieving its objectives .... includ[ing] relationships with employees, customers and suppliers and the company's impact on the wider community'.[34] Disclosure is also the main focus of the reforms in the United States under the *Sarbanes-Oxley Act 2002* (US), although those reforms could be considered as being more limited to addressing the concerns of stakeholders traditionally protected by law, and to shoring up confidence in the market generally.

Given the scrutiny of corporate social and environmental practices, the proponents of which in the commercial sphere are predominantly ethical investment funds, it could be said now that the 'market'— at least in an economic sense — is starting to regulate itself.[35] Enhanced disclosure requirements would enhance the effectiveness of this market pressure to make companies comply with social and environmental regulations, and to ensure that any claim to be adopting socially responsible business practices is justified by companies reporting against implemented programs. While such reporting requirements do not of themselves require any improvements to be made to the triple bottom line being reported, they do at a minimum increase the public profile of those factors, and help to legitimise them as being relevant to the overall conduct of a company's operations.

Conclusion

The current law is capable of supporting a broad range of philanthropic and 'socially responsible' activities and 'sustainable' business practices. While such acts are directed among other things at enhancing the profitability of the company, they may nevertheless have a genuinely beneficial impact on the stakeholders whose interests those policies seek to promote. However, directors face uncertainty in relation to whose interests they may legitimately consider in determining what is in the company's best interests.

Law reform should be directed towards both helping directors to determine where on this spectrum the company can sensibly sit, and requiring companies to meet community expectations regarding the social and environmental impact of companies in the community. An amendment to s 181 to permit directors to take a wider range of interests into account, if sufficiently linked to the fortunes of the company, would go some way to resolving the existing uncertainty. However, new or more detailed social and environmental responsibilities should be set out in specific legislation, rather than through inclusion within director's duties, both for reasons of appropriateness and clarity, and to facilitate the ability of directors to meet such obligations with as much confidence as possible. Both approaches, the prescriptive and the permissive, should be coupled with enhanced disclosure requirements to ensure shareholders, the investment market and also the broader community are better able to assess a company's performance regarding socially responsible practices.

PETER HENLEY is a solicitor at Mallesons Stephen Jaques in Melbourne, and the Melbourne Coordinator of the Mallesons Human Rights Law Group.*

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33. See, eg BHP Billiton, *Health Safety Environment and Community Report* (2004), available at <http://hsecreport.bhpbilliton.com/2004/index.asp> at 31 May 2005.

34. British Department of Trade and Industry, *Modernising Company Law*, 'PART II — Modernising Company Law: The Government's Policy' [4.31] <www.dti.gov.uk> at 2 August 2005.

35. See, eg 'Uranium May Force Ethical Funds to Sell Out of BHP', *Infochoice.com.au* (Australia), 16 March 2005, <www.infochoice.com.au> at 2 August 2005.

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