Corporate social responsibility: using climate change to illustrate the intersection between corporate law and environmental law

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Introduction

The relationship between corporations and the environment is complex and detailed. The impacts that corporations have on the environment include the use of primary resources to make products; the use of energy and water and the production of waste and emissions. There is also the impact of the use of these products on the environment. The impact of corporations on the environment is enormous.

The environment can also have an enormous impact on corporations. Some examples include the impact of the drought, the effects of climate change, the loss of resources such as fish, the loss of our coral reefs affecting tourism, the restrictions placed on development due to the protection of threatened species and heritage listings, and the restricted use of water and energy in industry.

Decisions made by companies, which are regulated by corporate law, are responsible for a large part of all environmental impacts. Over more than 40 years since the actions of corporations were recognised as being potential threats to the environment, there has been a significant shift in thinking. Initially the focus was on pollution and end-of-pipe technology. Environmental legislation which prohibited, or at least controlled the levels of pollution, was passed. Now there is recognition of the systemic nature of the threat to the environment posed by human production and consumption and the focus is rapidly moving back up the production chain to the design of products and processes.

Environmental law can only go so far - it cannot, and should not, prescribe every decision taken by every business. Rather, consideration of environmental issues - the direct and indirect environmental impacts of the business, the environmental issues of concern to the wider community, and the risks and opportunities associated with them, should be part of good business practice.

The purpose of this paper is to look at the intersections between corporate law and environmental law. In the main, I will be looking at corporate social responsibility which defines this intersection. Within this broad area, there are three areas where this intersection has, or has the potential to occur. The three areas are stakeholders, directors' duties, and disclosure. It is important to stress that corporations' and directors' environmental performance are predominately governed by statutes other than the *Corporations Act*. When talking about directors' liability and the harm directors may do to the environment, it is more fruitful for the focus to be on directors accounting for the harm that they do to the company itself, rather than directors accounting for the harm

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they do to the environment. The enforcement paths are much more clearly defined, as will be explained later in this paper.

What has happened in Australia over the past ten years? There have always been companies that have taken a leadership approach to environmental issues and have done well from this foresight and are thus well positioned for the future, such as Insurance Australia Group, and Westpac. Many companies in Australia, however, are not performing in cognizance of environmental issues – neither focusing on the risks nor strategizing for the opportunities that can result from the integration of and focus on these issues. Overall, there has not been much change and what change there has been is slow and is falling behind international trends. In consequence of this, it is doubly disappointing to look at the recent reports of the Parliamentary Joint Committee on Corporations and Financial services[2] and the Corporations and Markets Advisory Committee (CAMAC)[3] whose recommendations suggest that Australia should continue pretty much with business as usual.

Do most Australian corporations adequately consider environmental issues? No – they do not! So what might be done to change this? Do we need changes to corporations law or supplements to corporations law such as guidelines or incentives? Is education the way forward and/or do we need some test cases in relation to the corporations law in the courts? This paper will critically examine the current situation in Australia and suggest some ways of moving forward to capitalise on the inevitable connections between corporate law and environmental law.

This paper begins by setting the context in terms of sustainable development and the legislative powers in Australia, and how the international business community has embraced the concept of sustainable development. Part 2 will examine corporate social responsibility (CSR) in Australia, by firstly considering the history and various approaches of CSR followed by the CAMAC report and its findings. The next three chapters will discuss stakeholders, the role of directors and disclosure and reporting. The paper will conclude with a case study on climate change.

Background:

It is important to set the context of this discussion and so this paper will begin by examining the concept of sustainable development, briefly in its historical and current context, both internationally and domestically.

The phrase sustainable development was first used by Gro Harlem Bruntland, as head of the UN World Commission on Environment and Development, in the 1987 Commission Report, Our Common Future (known as the Brundtland Report). She defined it as

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[2] Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* July 2006
http://www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/report/index.htm
[3] Corporations and Markets Advisory Committee Report "The Social Responsibility of Corporations" December 2006

"development that meets the needs of the present without compromising the ability of future generations to meet their own needs"[4]

The implementation of sustainable development was the focus of the 1992 UN Conference on Environment and Development in Rio de Janeiro. Several key documents were produced as a result of this Conference: the Rio Declaration (a statement of general principles needed to achieve sustainable development), Agenda 21 (an global, national and local action plan) and two Conventions, one on Biological Diversity incorporating the Cartagena Protocol on Biosafety[5] and the UN Framework Convention of Climate Change[6], under which the Kyoto Protocol was made. The Rio Declaration[7] sets out 27 general principles relating to environmental protection and sustainable development.

Australia's response to sustainable development can be described as threefold: the policy response; the legislative reforms and the initiatives of the judiciary[8]. The federal government does not have a separate environment head of power under s51 of the Constitution. As a result of this, the States play the major role in environmental legislation. The federal government has, however, enacted environmental legislation under the corporations power, the external affairs power and the trade and commerce powers of the Constitution. Recently, the High Court in its Industrial Relations (Work Choices) decision[9] confirmed the expansive construction of the corporations power, s51(xx). At para [567]. Kirby J quotes Professor Ron McCallum who states that, "in the fullness of time, these labour laws will become little more than a subset of corporations law because inevitably they will fasten upon the economic needs of corporations". In a more positive sense, it is also possible for much environmental law to be subsumed and recognized within corporation law.

Following the Brundtland Report and the Earth Summit, all governments in Australia accepted the principles of environmental policy set out in the Intergovernmental Agreement on the Environment (IGAE)[10] and the core objectives and guiding principles set out in the 1992 National Strategy for Ecologically Sustainable Development (NSESD)[11]. The IGAE states, in summary:

> [ESD] requires the effective integration of economic and environmental considerations in decision-making processes, in order to improve community well-being and to benefit future generations… [The following principles] should inform policy making and program implementation... precautionary principle…

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4 Bruntland, G, "Our Common Future" Oxford University Press 1987 p44
5 *Convention on Biological Diversity* available at http://www.biodiv.org/doc/legal/cbd-en.pdf
6 UN *Framework on Climate Change* available at http://unfccc.int/essential_background/convention/background/items/1349.php
7 http://www.unep.org/Documents.multilingual/Default.asp?DocumentID=78&ArticleID=1163
8 Fisher, DE. 'Sustainability – the Principle, its Implementation and its Enforcement' (2001) 18(4) *Environmental and Planning Law Journal* 361, 363.
9 *New South Wales* v *Commonwealth of Australia; Western Australia* v *Commonwealth of Australia* [2006] HCA 52 (14 November 2006)
10 http://www.deh.gov.au/esd/national/igae/
11 http://www.deh.gov.au/esd/national/nsesd/index.html

> intergenerational equity… conservation of biological diversity and ecological integrity… improved valuation, pricing and incentive mechanisms[12].

The National Strategy adds to the above principles by stating that decision-making processes should effectively integrate both long and short term economic, environmental, social and equity considerations[13]. Since the introduction of the National Strategy, ecologically sustainable development has become the most important criteria for environmental management, as statutory requirements to 'have regard to' ESD when making decisions appear not only in environmental legislation but in a wide range of legislation conferring discretionary powers upon a wide range of government agencies. Accordingly, the reach of sustainable development in Australia has been extended to all manner of governmental bodies, many of whom were previously under no express directions to have regard to ESD principles in exercising their statutory functions[14].

The judiciary has examined the power or obligation on certain parties to take ESD into account, and has recognised particular characteristics of sustainability[15]. For example, it has been recognised that the precautionary principle, as a component of sustainability, is a relevant factor in decisions involving conservation of environmental protection[16]; and that invoking the concept of ESD invites the use of the precautionary principle[17]. The existing case law indicates the judiciary is increasingly prepared to ensure that difficult concepts such as sustainability, however formulated in legislation, are given effect according to the apparent intent of the legislature[18]. Today, much of our legislation requires decision-makers to take ESD principles into account. In *Gray* v *The Minister for Planning and Ors*[19], the court had to decide whether the contribution to climate change from greenhouse gas (GHG) emissions from the burning of coal, was an appropriate factor to be considered in the environmental assessment of a large coal mine. Pain J held that it was[20] and that ESD principles should have been taken into account by the Director-General. He failed to take intergenerational equity into account in terms of downstream GHG emissions and also failed to take the precautionary principle into account.[21]

The international and Australian business community has also embraced this concept of sustainable development. The World Business Council for Sustainable Development[22] was established in 1995 and the Business Council of Australia has been relatively active

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[12] Inter-Governmental Agreement on the Environment, paras 3.2 – 3.5
[13] Fisher, DE. 'Sustainability – the Principle, its Implementation and its Enforcement' (2001) 18(4) *Environmental and Planning Law Journal* 361, 363.
[14] Bates, Gerry. *Environmental Law in Australia* (2006, 6th edition), 117.
[15] Fisher, DE. 'Sustainability – the Principle, its Implementation and its Enforcement' (2001) 18(4) *Environmental and Planning Law Journal* 361, 364.
[16] *Leatch v National Parks and Wildlife Service* (1993) 81 LGERA 270
[17] *Tuna Boat Owners Association v Development Assessment Commission* (2000) 110 LGERA 1 per Doyle CJ.
[18] Fisher, DE. 'Sustainability – the Principle, its Implementation and its Enforcement' (2001) 18(4) *Environmental and Planning Law Journal* 361, 364.
[19] [2006] NSWLEC 720 (the Anvil Hill case)
[20] ibid [100]
[21] ibid [125], [126], [135]
[22] www.wbcsd.ch

in promoting the concept, though Australian companies have been quite slow and resistant to adopting the principles which attach themselves to this concept.[23] The actions that companies take in this regard need to be accompanied by a form of communication, such as reporting, informing shareholders and other stakeholders of the environmental, social and economic impact of their activities. This type of reporting began in the 1980's as a response to community concern, and concern on the part of the company to protect its reputation. This voluntary reporting has continued to the present day but stakeholders did become very skeptical of this reporting as it was big and glossy and had no verification and the reporting was mostly descriptive, not quantitative. It was often branded as "greenwash" and regarded as unreliable. Those companies, such as Novo Nordisk, which were operating within strict environmental policies, and which wanted to disclose credible information, began to do quantitative reporting which was verified independently by a reputable organization. This reporting was done through the production of stand alone environmental reports.

In 1996, John Elkington of SustainAbility[24] used the term 'triple bottom line' reporting indicating the reporting of economic, social and environmental bottom lines. His concern was that externalities were not being taken into account when decisions were being made by companies and this still remains one of the most insidious problems in corporate and government decision-making. Externalities are costs or benefits that are not included in company accounts. They range from such things as - time sitting in congested traffic jams to and from meetings, - to the health costs of polluting emissions from a factory, - to the increase in property prices resulting from the location of a high technology industry plant that denies local people the ability to buy in that area.

Some of these externalities are now being reported on however even the Global Reporting Initiative[25] (GRI) in its latest guidelines, falls short on this. Triple bottom line reporting has been replaced by sustainability reporting. The GRI Sustainability Guidelines were introduced in June 2000, revised in 2002 and the latest revision, known as G3, began in October 2006. It is beginning to be recognized as a global benchmark for sustainability reporting. Companies adopting these guidelines must provide a description of their governance and management systems and assess and report on the environmental, social and economic effects of their activities by reference to various indicators.

Environmental performance means an organisation's impact on living and non-living natural systems, including eco-systems, land, air and water. Social performance means an organisation's impact on the social system within which it operates. This includes labour practices, human rights and other issues affecting consumers, the community and other stakeholders in society. Economic performance means an organisation's impact on the economic resources of its stakeholders and on economic systems at the local, national and global levels.[26] SustainAbility, in its 2006 survey of sustainability reporting[27], found that

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[23] See Inter-governmental Agreement on the Environment at fn 9

[24] Engaging Stakeholders Program was established by SustainAbility and UNEP in 1995; and Elkington, J Cannibals with Forks: The Triple Bottom Line of 21st Century Business 1998 Capstone Publishing, Oxford

[25] www.globalreporting.org

[26] Global Reporting Initiative *G3 Sustainability Reporting Guidelines* 2006

in addition to corporate risk, leading companies are focusing on market opportunity and that value creation is surfacing as a theme. It also found that although investors have a baseline of risk reporting, they are becoming increasingly interested in the opportunities for market growth, market share and profits[28]. However, the report found that many companies are not yet reporting with analysts in mind.

Longitudinal research by KPMG[29] has shown that there has been an increase in CSR reporting over the last ten years, particularly in the past three years.[30] The uptake in Australia is low compared to international standards. Out of the top 100 Australian companies, CSR reporting has increased from 14% in 2002 to 23% in 2005, with Australia being ranked eleventh out of the sixteen countries surveyed in the KPMG report. But putting this in a broad context, less than 4% of the world's 50,000 major companies report on corporate social responsibility issues.[31]

A recent comparative study of CSR reporting across Norway, the Netherlands and Ireland[32] compared what was mandatorily required to be reported under Norwegian legislation across the three jurisdictions. Norwegian companies are required to report on their impact on the external environment[33], the working environment, and gender equality in their annual report. The research found that companies reported best on the working environment and gender equity and that the external environment was neglected.[34] It is a surprising result in that even in countries with a strong reputation for environmental consciousness, such as Norway and the Netherlands, reporting was weak. This may indicate that it is a real challenge to develop a synergy between company law and environmental law.

Corporate Social Responsibility in Australia

What is the role of the company and its directors in managing the company? The area of corporate social responsibility is a natural alignment between companies and the environment. Corporate social responsibility has been defined by CAMAC as the extent to which companies do, or should, take into account the environmental and social impact of their activities. It has also been defined in an Australian Standard as "A mechanism for entities to voluntarily integrate social and environmental concerns into their operations and their interaction with their stakeholders, which are over and above the entities legal

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[27] SustainAbility, UNEP and Standard and Poor's, (2006) Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting http://www.sustainability.com/compass/download_file.asp?articleid=196 accessed 2 February 2007
[28] ibid p1
[29] KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005* www.**kpmg**.com/Industries/IM/Other/CR**Survey**.htm accessed 31 January 2007
[30] 52% of the Global 250 companies and 33% of the top 100 companies in 16 countries provide some form of CSR reports. 40% of these reports worldwide use the GRI guidelines.
[31] Ernst & Young, *Risk Management Series* (5th Edn July 2005) at 3
[32] Vormedal, I, et al "Sustainability Reporting in Norway, Netherlands and Ireland: A Comparison" 2006 paper given at the Greening of Industry Conference, July in Cardiff.
[33] Natural environment
[34] Ibid.

responsibilities."[35] There are proponents on both sides arguing as to what is the proper role of the company and its directors in managing the company. Is it to maximize profits or can they have a wider perspective?[36] The shareholder primacy view states that there is a principal /agent model and corporate managers must maximize shareholder wealth, only. A different view to this is the team production view of the corporation which says that the proper goal for a board of directors is to 'build and protect the wealth-creating potential of the entire corporate team' with wealth also being reflected in good corporate citizenship in the community.[37]

i) History and approaches:

Corporate responsibility has been around for some time. Initially in the US, it focused on the social impact of takeovers. A case in 1986[38] said that the board of a takeover target could take non-shareholder interests into account in a takeover bid only where a 'rationally related benefit' would accrue to shareholders. This meant that they could not take into account any detrimental social effects such as relocation of factories or retrenchment of employees. As a response to this, many US states adopted 'corporate constituency' statutes which allowed directors to broaden the constituencies they could take into account in corporate decision-making. Examples would include the effects of actions on employees, suppliers, customers and communities where the company was located.

There is some debate as to whether the current disclosure rules in the US are enough for companies to provide sufficient information for investors and other interested parties on their environmental and social impact. There are different approaches to social responsibility including the compliance, philanthropic and business approaches (all of which are linked to corporate benefit) and the social primacy and social obligation approaches (which are not necessarily linked to corporate benefit).

The compliance approach states that corporations must comply with the law even though shareholder gain may not be enhanced. There is no further obligation than this but it has been argued that full compliance includes compliance with the spirit as well as the letter of the law. SustainAbility in a 2005 report argues that companies may be under a "moral liability" which is rapidly being coupled with a legal liability,

[35] Standard Australia, (2003) AS 8003-2003

[36] Many years ago, Milton Friedman espoused the view that directors using corporate resources for broader environmental or social purposes is tantamount to mismanagement of shareholder funds. (Capitalism and Freedom University of Chicago Press 1962) cited in CAMAC report p21.

[37] Blair, M and Stout, L, "Specific Investment and Corporate Law" *European Business Organisation Law Review*(forthcoming) as cited in CAMAC Report, p24

[38] Revlon Inc v McAndrews & Forbes Holdings Inc 506 A.2d 173 (Del. 1986)

> "….Technical innocence or escaping accountability through legal expertise and subtle arguments on points of legal interpretation and precedent are becoming increasingly unacceptable in a society that expects real world performance and behaviour standards."[39]

The philanthropic approach encompasses companies giving in ways above and beyond their main business activities. Commentators have questioned whether there is a proper basis for this corporate philanthropy. The Hon, Sir Gerard Brennan, former Chief Justice of the High Court, has said that investors do not authorize directors to dispose of corporate assets to charities of their choice. He argued that the choice should remain with the individual investor to do what they wish out of their share of the distributed profits.[40] In the HIH Royal Commission Report, Justice Owen said that discretionary payments in the form of a donation from shareholder funds should be undertaken in a transparent and justifiable way with full regard to the interests of shareholders.[41] It seems that on these two approaches, corporate philanthropy needs to be justified in terms of the business interests of the company. Examples of this would be where the company's reputation is enhanced or it is supporting certain communities.

The US has gone further and widened the range of corporate philanthropic activities, as in the American Law Institute (ALI) Principles of Corporate Governance model clause 2.01(b)(3) which states,

> Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.[42]

Similarly the New York Business Corporations Law s202(a)(12) contains a default rule that a corporation has the power:

> To make donations, irrespective of corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes, ….[43]

This certainly goes further than would be the case in Australia.

The business approach or enlightened self-interest approach takes the view that operating within an active environmental context will be in the company's own commercial interest. The two aspects of this approach are: enhancing corporate value or opportunity, and managing corporate risk. There has been much research undertaken on whether the adoption of environmentally and socially responsible policies will improve a company's

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[39] SustainAbility Report (2005) "The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability" http://www.sustainability.com/insight/liability-article.asp?id=180 p.5 accessed 29 January 2007

[40] The Hon, Sir Gerard Brennan, "Law values and charity" (2002) 76 Australian Law Journal 492 at 497

[41] April 2003, Vol.1 at p120.

[42] American Law Institute (ALI) *Principles of Corporate Governance,* clause 2.01(b)(3) referred to on p39 CAMAC report

[43] http://law.onecle.com/new-york/business-corporations/BSC0202_202.html accessed 2 February 2007

financial performance.[44] One of the difficulties with this is the measurement of intangible asset value. Even so, it is now well established that taking environmental and social issues into account does not detract from investment performance.[45] The long term establishment of the two sustainability indices is evidence of this.[46]

The intersections of enhancing corporate value and opportunity and managing corporate risk can be seen in the area of climate change. The risks related to climate change include - reduced profit margins, higher operating costs due to increased costs of energy, loss of reputation; and the opportunities include - positive impacts such as enhanced reputation and higher profit margins.[47] The enlightened self-interest approach seems the one with the most potential to merge corporate strategy with environmental outcomes. Many companies see environmental issues as relating to risk management and minimisation of liabilities - few have seen the opportunities, however, there are many opportunities especially in the area of climate change.

Take, for example, the construction and engineering industries. There will be increased costs to these industries due to higher energy prices and a changed market demand towards low carbon intensive products and more exposure to greenhouse gas emission regulation but the opportunities will lie in innovations which will reduce the carbon intensity of industrial processes and develop less carbon-intensive building products. The 2006 survey from SustainAbility found that 6 out of the 50 leaders mentioned entrepreneurship in their reporting which was a giant leap from previous years.[48] The report argues that the agenda is shifting to include influence, not just performance. That is, how are companies using their influence and advocacy to support sustainable development?

The list of companies that have recognized that environmentally sound practices can enhance corporate value and opportunity is long and varied eg Ray Anderson of Interface Carpets. Companies have also begun to recognize the importance of managing non-financial risks. This action may not immediately result in increasing profits but failure to manage these risks may cause extensive harm. Harm could include increasing operating costs and attracting regulatory intervention in response to the damage caused by the risk, as well as the risk of adverse litigation and brand damage. Failure of directors to properly consider these risks could result in their replacement by shareholders under sections 203C and 203D *Corporations Act* 2001. A change in the company's risk profile could affect the company's credit rating and insurance policies of directors and officers.

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[44] Report by UNEP Finance Initiative, *Show me the money: Linking Environmental, Social and Governance Issues to Company Value* (2006) http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf accessed 1 February 2007 which showed across eight industry sectors a direct link between attention to ESG issues, financial value and company profitability.

[45] Ibid.

[46] The Dow Jones Sustainability Index, established in 1999 and the Ftse4Good, launched in July 2001

[47] Carbon Disclosure Project Report 2006 Australia and NZ www.cdproject.net/download.asp?file=CDP4_**Australia_Report**.pdf accessed 18 January 2007

[48] SustainAbility report fn 26 p29

The social primacy approach is where directors take a company's ethical values into account whether or not it enhances corporate profit or shareholder gain. A company may decide not to do business with an organisation which fails to meet certain environmental or social standards. For example Streetwize Communications, whose mission is to create socially informed and empowered communities[49], has an ethics policy that limits the companies with which it will do business. The American Law Institute (ALI) commentary on principle 2.01(b)(2) of its Principles of Corporate Governance model[50], recognizes the conflict that can exist between financial and ethical considerations. Where conflict exists between ethical considerations and corporate profitability, the ALI states that the most desirable and appropriate course would be to comply with the ethical considerations even though this would not enhance corporate profit or shareholder gain.[51]

The social obligation approach is a proactive version of the social primacy approach which states that because a company has access to valuable resources and the privilege of limited liability, it is obliged to advance public welfare even where there is no discernable benefit to the company in doing so.[52] The basis behind this is that the voluntary sacrificing of profits will, in the long-term, have benefits and consequences far superior to those flowing from the narrow pursuit of pure profit maximisation.

ii) the CAMAC report and its findings:

Australia has recently considered which approach should be taken to encourage corporate responsibility. There were two parallel enquiries with similar terms of reference. The Parliamentary committee report[53] recognised the need to balance the long term view of a company's viability and profitability with a focus on short term returns. It favoured the 'enlightened self-interest' interpretation of directors' duties rather than the narrow view of maximising profit. A parallel inquiry was undertaken by the Corporations and Markets Advisory Committee (CAMAC) and this report was released in December 2006. CAMAC was asked to consider four questions:

- Should the Corporations Act 2001 (Cth) 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?
- 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?
- Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and, if so, how?

[49] Streetwize Communications annual report www.streetwize.com.au/annual reports/annual_report2006.pdf
[50] This principle provides, "Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business, may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business".
[51] CAMAC report p53
[52] ibid
[53] Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* July 2006
http://www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/report/index.htm

- Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

The terms of reference for these reports was both timely and opportune but the recommendations from these reports indicate that this opportunity has been lost. Part of the justification for the recommendations which were pretty much 'business as usual' was the existence of s299A *Corporations Act* 2001[54] and Accounting Standard 212[55]. The accounting standard states that the company's auditor should read other information, to identify material inconsistencies with the audited financial report, and then report on these. Although this has the potential to apply to environmental disclosure under s299A and s299(1)(f) *Corporations Act*[56], in the example given in the standard, no mention is made of environmental disclosure and the intention was clearly on other non-financial information.[57] This standard was enacted in 1995. Unless there is more effective enforcement of this provision, it is unlikely that its potential in this area will ever be fulfilled. With regard to s299A *Corporations Act* 2001, there is potential for s299A to effect adequate disclosure but Australian companies have been laggards in the area of voluntary reporting[58] and there is very little indication that this is changing. There is no indication that s299A will result in better disclosure in this area, despite the optimism in the CAMAC report[59].

The major findings of the CAMAC report were:

- A recognition of the importance of corporate responsibility;
- Amendments to directors' duties were not necessary as the current common law and statutory requirements were sufficiently flexible to enable directors to take stakeholder interests into account in their decision-making;
- Where legal protection for social and environmental interests are needed, this should be done through specific legislation directed to the problem area;
- Rejection of the UK approach in its new *Companies Act* 2006
- Reporting under s299A *Corporations Act* 2001 should be extended beyond public companies;
- Mandatory reporting on social and environmental reporting would result in a 'tick the box' culture, which should be avoided. Instead there could be changes to the ASX Listing Rules and ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations;*

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[54] General requirements for disclosure in directors' reports.

[55] AUS 212 *Other Information in Documents Containing Audited Financial Reports* (October 1995)

[56] Mandatory disclosure of environmental performance required in the directors' report.

[57] AUS 212 states at .06 'Example of other information include a report by management or the governing body on operations, financial summaries or highlights, employment data, planned capital expenditures, financial ratios, names of officers and directors and selected quarterly data'.

[58] KPMG 2005 Report fn 28

[59] CAMAC Report at pp145-146

- Government could encourage progress in this area by means such as encouraging cooperation in the formulation of codes and guidelines by the corporate sector.

The CAMAC report recognised that many corporations are beginning to understand and manage environmental risks. Companies ignoring environmental risks are doing so at their own peril. Companies should be warned that although the report takes a ‘business as usual’ approach, if, as a response, companies are slow to incorporate environmental and social issues into their business strategy, there is always the possibility of introducing legislative reforms similar to those that have been introduced in the UK.[60] This reform does not make a huge change but it does expressly focus the mind of the directors on ‘the impact of the company’s activities on the ….environment”.

By taking this ‘business as usual’ approach CAMAC has failed to capitalise on the potential opportunities which exist in all sectors, which a forward looking social and environmental strategy could achieve. Some companies are crying out for some direction and guidance on this and the federal government could encourage this focus by directors through a range of initiatives which are discussed later in this paper. There are three areas where good business practice can incorporate the overlap between corporate and environmental law. These are the areas of stakeholders, the role of directors and disclosure.

iii) Stakeholders

What is the role of stakeholders in corporate social responsibility? Stakeholders have been recognized as a group, wider than shareholders, who can be affected by the conduct of a company. But do companies have an obligation to focus on their impact on stakeholders? The GRI have defined stakeholders as

> Those groups or individuals that: (a) can reasonably be expected to be significantly affected by the organisation’s activities, products and/or services; or (b) whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives. This would include shareholders, financiers and creditors, employees, consumers, adjacent communities, NGO’s.[61]

Taking into account the needs and expectations of a range of stakeholders and not just focusing on the immediate returns to shareholders, can be argued to be in the company’s interests and consistent with longer term shareholder value, but the weight to be given to these stakeholders would be a matter for the directors’ commercial judgment. It should be noted that stakeholders can have major influence on companies. Financiers should be concerned with how a company manages its environmental, social and governance (ESG) risks and their effect on corporate financial viability. This could have an effect on a company’s ability to attract equity or loan capital. An example can be seen in relation to climate change where in 2006, a group of global institutional investors prepared a

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[60] See p.19 of this paper.
[61] Global Reporting Initiative, 2006, G3 Sustainability Reporting Guidelines p.41

document[62] setting out the information they would require from a company in which they would invest, in order to analyse its business risks and opportunities resulting from climate change.

Funders now seem to be concerned about a company's long term viability. Socially Responsible Investment (SRI) funds are now wielding some influence on company behaviour. In 2006, managed SRI portfolios in Australia were at $11.98 billion, which represented 1.54% of total funds under management. This was up from 0.73% in 2004.[63] In Canada, in 2004, there was C$65.46 billion in assets managed under SRI guidelines, representing 3.6% of total funds under management.[64] In the US, in 2005, there was US$2.29 trillion in managed SRI funds which represents 9.4% of all assets under management.[65] In 2006, based on data up to December 2005, there was 1.033 trillion euros in the broad European SRI market which represented 10-15% of the total European funds under management.[66] Although it is difficult to make country comparisons because there are different definitions of SRI and different methodologies, it is clear that the market in SRI is substantial and its market share is increasing.

Other stakeholders include employees - corporate reputation may play a part in retaining the most talented employees. Customers and consumers can have a powerful influence on company behaviour. This can be seen in the amount of recycled products on supermarket shelves and the backlash against Nike for the exploitation of workers in the production of their products, and the change by Nike in response. There are also examples of the power of NGO's in changing corporate behaviour, some through shareholder activism, such as the Wilderness Society actions against the Commonwealth Bank for its investment in the woodchipping company, Gunns Ltd. As a result, the Commonwealth Bank sold off its shares to bring its ownership of Gunns down from 17% to 4.89%. The bank denied that this selling off had anything to do with the action of the NGO.[67] It seems that the timing was just co-incidental.

Another effective campaign from an NGO can be seen by the Rainforest Action Network (RAN) with regard to Citigroup. In April 2000, RAN branded Citigroup as the most destructive bank in the world because of its role in the destruction of the world's remaining old growth forests and resultant acceleration of climate change. It ran a campaign for four years including full page newspaper and television advertisements, demonstrations and protests, and two years of negotiation and dialogue.[68] As a result of this, in 2004 Citigroup, the world's largest financial services company, announced it had adopted a comprehensive environmental policy that ensures protection for endangered ecosystems and begins to confront the crisis of climate change and "sets a new standard

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[62] The Global Framework for Climate Risk Disclosure (October 2006) http://www.ceres.org/pub/docs/Framework.pdf accessed 2 February 2007.
[63] http://www.eia.org.au/files/PF5QGPZHO2/SRI%20Benchmarking%20Report%202006%20EIA.pdf
[64] http://www.socialinvestment.ca/SIReview04-original.pdf
[65] http://www.eia.org.au/files/PF5QGPZHO2/SRI%20Benchmarking%20Report%202006%20EIA.pdf
[66] This represents 36% growth since 2002. *The 2006 European SRI Study* (October 2006)
[67] Whinnett, E, "Big parcel of Gunns sold by bank" *Hobart Mercury* 30 April 2004, p1-2
[68] http://www.ran.org/what_we_do/global_finance/hist/citibank/

for the financial services industry"[69] These new policies support and extend Citigroup's recent signing of the Equator Principles, including principles to assess project financing requests that might hurt the environment, and a policy to implement special measures aimed at protecting ecological or social "high-caution zones"[70]. RAN described these new initiatives as the "most far-reaching set of environmental commitments of any bank in the world"[71].

This recognition of the importance of stakeholders to companies and their decisions is supported by the Australian Stock Exchange (ASX) *Principles of Good Corporate Governance and Best Practice Recommendations.* Draft Principle 3 (Promote ethical and responsible decision-making) (November 2006) states

> To be successful, companies need to have regard to their legal obligations and the interests of a range of stakeholders including shareholders, employees, business partners, creditors, consumers, the environment and the broader community in which they operate. It is important for companies to demonstrate their commitment to appropriate corporate practices and decision making.[72]

The ASX recommends that companies establish a code of conduct detailing their legal obligations and the expectations of their stakeholders.[73] Principle 7 relates to recognising and managing risk. In its commentary and guidance to recommendation 7.1, it says that a company needs to determine what its 'material business risks' are and that they may include environmental and sustainability risks[74]. The company's risk management policy should also take into account its legal obligations and the expectations of its stakeholders as failure to do so may threaten its reputation and success. It adds that effective risk management involves considering factors which bear upon the company's continued good standing with its stakeholders and the community.[75]

What is the status of these ASX principles and recommendations? The Principles of Good Corporate Governance are a voluntary code, coordinated by the ASX Corporate Governance Council. The ASX has an 'if not/why not' policy to enforcement. Under listing rule 4.10.3 companies are required to provide a statement in their annual report disclosing the extent to which they have followed these best practice recommendations but the Council recognises that not all recommendations will be appropriate for each company. If a company considers a recommendation is not appropriate, it needs to explain why. As listed companies have been so worried about investors expecting 100% compliance with these principles, this policy has not been exercised which has resulted in

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[69] Citigroup - Rainforest Action Network and Citigroup Announce Enhanced Citigroup Environmental Policy: http://www.citigroup.com/citigroup/environment/040122a.htm
[70] Citigroup - Rainforest Action Network and Citigroup Announce Enhanced Citigroup Environmental Policy: http://www.citigroup.com/citigroup/environment/040122a.htm
[71] Rainforest Action Network – Citibank: 2000 – 2004: http://ran.org/what_we_do/global_finance/hist/citibank/
[72] ASX Corporate Governing Council *Principles of Good Corporate Governance and Good Practice Recommendations* Exposure Draft of Changes, November 2006, p20
[73] Ibid p.20, Recommendation 3.1.2
[74] ibid p.31
[75] Ibid p.32

a trend towards compliance of these principles.

Although there is still some debate, internationally, on the precise relationship between a company and its stakeholders, the recognition that companies should be taking a broader obligation approach to stakeholders, including the environment, gives strength to the argument that company law and environmental law have the potential for closer alignment.

iv) Director's duties

One of the terms of reference of the Australian reviews was to look at the role of directors in the area of corporate social responsibility. The question to be considered was whether directors are in breach of their fiduciary duty if they take non-shareholder stakeholder interests into account in their decisions. Directors are subject to common law and statutory duties. At common law, directors must act in the best interest of the company as a whole, which has been interpreted to mean the financial interests of the shareholders as a general body.[76] The interests of the company can include long term benefits[77]. The case law in this area has supported the view that directors have considerable discretion in determining what will benefit the company. As the High Court said in *Harlowe's Nominees Pty Ltd* v *Woodside (Lakes Entrance Oil NL)*[78],

> "Directors…….may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts."[79]

More recently, the Canadian Supreme Court stated,

> "….in determining whether [directors] are acting with a view to the best interests of a corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[80]

It seems that in terms of corporate philanthropy, donations must be made as part of a business strategy with the primary motivation being to enhance the interests of the company.

The statutory duties on directors of most relevance to this discussion are ss180[81] and 181[82] *Corporations Act*. The standard of care and diligence is objective and failure to so act must be reasonably foreseeable that the conduct might harm the interests of the company.[83] This could apply where a director has not prevented an environmental law being breached if it could be shown that it was reasonably foreseeable that the interests of

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[76] Greenhalgh v Arderne Cinemas [1950] 2 AER 1120; Ngurli v McCann (1953) 90 CLR 425
[77] Darvall v North Sydney Brick and Tile Company (1989) 15 ACLR 230
[78] (1967) 121 CLR 483
[79] ibid, at 493
[80] *People's Department Stores Inc* v W*ise* (2004) 244 DLR 564 at [42]
[81] s180 says that directors and corporate officers must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise in the same position.
[82] S181 says that directors and corporate officers must exercise their powers and discharge their duties in good faith and in the best interests of the corporation, and also for a proper purpose.
[83] ASIC v Vines (2005) 55 ACSR 617

the company would be harmed either through reputation or through some pecuniary penalty. There is a defence in s180(2) if the director can show that they rationally believed that their judgment was in the best interests of the company and that the belief will be regarded as rational unless it is a belief that no reasonable person in their position would hold.

In terms of s181 *Corporations Act*, for directors to act 'in the best interests of the corporation', their decision does not have to be the best possible decision for the company. Commentators have suggested that management can implement a policy of enlightened self-interest but will be restricted where there is no prospect of commercial advantage to the company.[84] Directors must also exercise their powers 'for a proper purpose'. This is an objective test and the subjective view of a director will not be relevant, 'if no reasonable board could consider a decision to be within the interests of the company'.[85] However, most of the cases have focused on internal issues and the courts have not yet considered the limits that this section may have on directors in considering the environmental and social context of their decisions.

Companies are subject to a large range of environmental laws and failure on the part of the directors to ensure that the company complies with these laws may put them in breach of their common law and statutory fiduciary duties. Directors cannot use the excuse that the financial interests of shareholders have priority over corporate compliance.[86] Could shareholders bring an action against the directors for breaching their statutory or common law duties to the company by not taking all steps to prevent the company from breaching, or causing the company to breach these environmental laws? This could be the case on the basis that the directors have breached their common law duty of care and diligence[87]. Take, for example, the situation where a company should put in systems to prevent environmental harm occurring. This could be a matter of ensuring that the systems within the company would satisfy the due diligence defence, say under the NSW *Protection of the Environment Operations* Act 1997.[88] There is support for this position from *ASIC* v *Adler*[89] where Santow J found that one of the relevant factors as to whether the duty of care and diligence had been breached was the failure of a director to put in place controls to avoid unlawful investments being made.[90]

What is the relationship between the corporation and environmental laws? Is breaching an environmental law a breach of a director's fiduciary duty towards the company? For example, if a director is found guilty of causing a pollution incident, they may be fined and sent to prison and the corporation may also be fined and ordered to clean up the

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[84] Austin, RP, Ford, HAJ & Ramsay, I, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005)
[85] *ASIC* v *Adler* (2002) 41 ACSR 72
[86] Bielefield, S, Higginson, S, Jackson, J and Ricketts, A, "Directors' duties to the company and minority shareholder environmental activism" (2004) 23 *Company and Securities Law Journal* 28
[87] Ford, Austin and Ramsay 10th Ed p323
[88] s169(1)(c). Also, see *R* v *Bata Industries Ltd* (1992) 70 CCC (3rd) 394 where the court set out what a director would need to do to satisfy the due diligence defence.
[89] (2002) 168 FLR 253
[90] ibid at [453]. This was in relation to the statutory duty under s180 *Corporations Act* 2001.

damage. But can an action be brought against the directors, and felt by the company, by its shareholders for a breach of its fiduciary duty? Individuals can decide to breach an environmental law because the cost of compliance exceeds the cost of the penalty associated with the breach. Individuals can risk their own reputation in this way however companies act through directors who owe it a fiduciary duty.

Environmental laws apply to 'persons' which include corporations and so they have the legal capacity and powers of an individual but they are not able to do an act which is prohibited by law[91]. If a company intentionally ignores a law which causes it to commit a crime, the board does so without power and in breach of its fiduciary duty to the company.[92] For example, the company cannot choose to pay the consequential fine rather than install a more expensive pollution control device.

Are there other enforcement roles for shareholders who want the company they have invested in or are thinking of investing in, to have more of a focus on environmental and social issues? Remedies under ss180 and 181 can be brought by the regulator or by the company itself. If the directors themselves, are the wrongdoers, it is unlikely that they will bring an action. Section 236 *Corporations Act* 2001 was introduced as a codification of the common law derivative action under the rule in *Foss* v *Harbottle.* This rule allows shareholders and former shareholders to bring proceedings on behalf of the company if the court finds that the company is unlikely to bring the proceedings themselves, that the applicant is acting in good faith, that it is in the best interests of the company that the applicant brings the action[93], and that there is a serious question to be tried. Shareholders could propose that a company includes in its constitution, a requirement that the board should take various environmental factors or goals into account. If passed, directors would then have to act in accordance with the company's constitution.

Finally, there is the process of shareholder environmental activism where, under the *Corporations Act* 2001, s249D, a minimum of 100 shareholders[94] is necessary in order to call an extraordinary general meeting, in which resolutions can be put forward. There have been successes by the Wilderness Society[95] using this process against North Ltd which, when taken over by Rio Tinto, announced a cessation in operations of the Jabiluka mine on environmental, social and economic grounds. Other successes include resolutions put to the Commonwealth Bank and NAB restricting the banks rights to invest in any industry or company that impacted on old growth forests and an extraordinary general meeting to get Gunn's shareholders to reconsider the company's involvement in woodchipping in Tasmania. The Wilderness Society's success can be attributed to effective lobbying to members and trustees of superannuation funds. Friends of the Earth International (FoEI) says that the value of these resolutions is to get the

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[91] s124(3) *Corporations Act* 2001 provides that for the avoidance of doubt, this section does not: (a) authorize a company to do an act that is prohibited by a law of a State or Territory;

[92] Bielefield fn 83, p39

[93] The argument here is that ensuring companies comply with the law is acting in the best interests of the company.

[94] There is a proposed amendment to cut out this trigger. If this should happen, then the trigger would be members with at least 5% of the vote.

[95] www.wilderness.org.au

company to voluntarily change its corporate practice. Rarely are these resolutions passed[96] but FoEI's view is that if an environmental resolution gets more than 10% of votes, a well governed company will take the relevant issue on board.

So far, this discussion has focused on the compliance role of director's duties however this paper argues that, in the absence of legislative reform, it is the business opportunities that will motivate directors to bring environmental and social perspectives into their strategy.[97] Climate change is one of the biggest challenges that companies face today as it has the potential to impact on the future of earnings, liabilities and general risk profile of companies across a range of industry sectors. But it brings with it enormous opportunities for these sectors.

Forward thinking investors and shareholders should be concerned as to how these companies are managing these risks and should ensure that associated opportunities are fully exploited. The question is - are Australian companies aware of and prepared to meet these challenges and opportunities? Will shareholders and investors understand the issues themselves and therefore drive the companies to respond effectively to climate change?

It is clear that directors need to take a long term view of shareholder welfare and that they need to have regard to both the future interests of members as well as their current interests. That is, they must consider the long term viability of the corporation.[98] A recent report has identified six impacts of climate change on economic activity:-

- The global economy is directly and indirectly linked to the earth's climate system
- Sectors such as tourism, agriculture and insurance are directly affected by increased adverse climate conditions such as droughts, floods and fires
- To address climate change, emissions must be reduced, most likely through a combination of carbon taxes, energy tariffs and emissions trading
- Other sectors will be impacted including the energy sector, and this will flow through to energy intensive sectors such as mining and manufacturing
- Other indirect impacts include reduced demand for products, disruption to business activities, potential litigation, as well as brand and reputational risk
- Longer term global impacts could include large scale refugee movement, political instability and social unrest.[99]

[96] The vote for the resolution with North was 6%; Commonwealth Bank 23% and NAB 22%
[97] Support for this can be found in the UNEP Financial Initiative report, "Show me the money" fn 42 which shows a verifiable link between the inclusion of ESG factors into a company's strategy and the financial success of the company.
[98] Bielefield fn 83, p38
[99] CD Project Report 2006 fn 43 p17

With these challenges come opportunities such as the development of markets for new types of fuels, producing products with low carbon intensities, such as video-conferencing, renewable energy opportunities, opportunities for innovation in agriculture[100], transport industrial processes and products.

Let us take the example of increased energy costs, once there is a price on carbon. This is a likely result of climate change policy, when externalities are factored into the price of energy. Companies that don't plan for the effect of these increases may lose profits and market share and an action could potentially be brought against their directors for breach of their fiduciary duty of care and diligence. Companies need to focus on the implications of climate change. Directors should be careful in engaging in activities for short term profit at the expense of long-term viability as they may be in breach of acting in the best interests of the company under s181.[101]

CAMAC was asked to consider whether the Corporations Act needs to be amended to get company directors to be more cognisant of the environmental and social context of their decisions. There are two possible approaches that could be taken. The first is the pluralist approach. It was argued that with a multi-stakeholder or pluralist approach, there could be conflict with varying stakeholders' interests. It could dilute the role of the director, who would have to take a number of interests into account and consequently, there may be less accountability to shareholders. The other approach, the enlightened shareholder approach requires the directors to act for the benefit of the shareholders as a whole but provides a wider context in which to fulfil this duty. This enlightened shareholder approach has been adopted recently in UK legislation.

Consider s172 UK Companies Act 2006 which provides:

> *Duty to promote success of the company*
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in so doing have regard (amongst other matters) to –
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.

The intention of this section is still to have the interests of shareholders as paramount. It emphasizes that the interests of non-shareholder groups are to be considered but only as it

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[100] NZ company PGG Wrightson are breeding grass plants with a high C:N ratio that will reduce the production of methane gas by grazing ruminants. Similarly Fosters Group, in light of the potential of reduced water supply, has upgraded their Qld brewery with a water recycling plant, doubling capacity with little additional water used.

[101] Bielefield fn 83, p39

promotes the interests of the shareholders. In terms of the environment, it could be argued that there are already environmental laws to which companies are subject and which they cannot avoid by arguing that non-compliance would maximize benefits to their shareholders. This may be so, but these other laws are prohibitive rather than permissive and compliance does not mean that the company is proactively considering environmental issues in their decision-making.

A provision similar to s172(1)(d) would focus the minds of the board on environmental issues which is a more effective way of improving a company's environmental performance[102]. It may be that it is in the company's best interest to consider environmental issues, and managing environmental risk, in terms of reputation and good practice and therefore there is no need to amend the current Corporations Act. This is a valid argument and directors in some companies, especially the large resources companies in Australia, align good environmental practice with good business practice however directors in most Australian companies do not,[103] and an amendment similar to s172 would focus their mind in this direction.

A study of six Norwegian companies was recently undertaken as a pilot to examine, in more depth, the effect that mandatory environmental reporting was having on the internal processes of the companies.[104] One of the questions focused on the role of the board in driving environmental performance. Statoil[105] suggested that priority attention on CSR and environmental issues from top management and the board will most likely have an effect. Other drivers which Statoil recognized were government regulation; what is important to the business; what is benchmarked for improvement purposes; industry standards; and what has been given priority attention in the society.

Statoil said that its board was proactive in monitoring environmental performance and it has discussed its response to climate change policies; the effect of oil spills on the environment and on its reputation; and the issue of co-existence with other users, for example, fisheries in the northern waters. The Statoil board also assessed environmental risk to the company by addressing - corporate HSE and CSR strategies; the key environmental aspects of Statoil's activities; risks related to all major business development proposals; and they have quarterly environmental reporting. Statoil also internalises environmental costs.

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[102] Bubna-Litic, K, "Compliance and enforcement of mandatory provisions: Is there a future?" paper presented at the 4th IUCN International Academy of Environmental Law Colloquium, "Compliance and Enforcement" October 2006, New York

[103] Although the latest research by the author on the mandatory reporting requirement found that 20% of the top 100 Australian companies in 2004 described the importance role of the board in integrating environmental issues into their decision-making. This was up from 3% from the 2002 results. See Bubna-Litic, fn 96 p.7

[104] ibid

[105] Statoil is the Norwegian state-owned oil and gas company, engaged in oil exploration and production in 15 countries.

The drivers for reporting within Storebrand[106] have been committed individuals as well as the environmental department and now the board. The CEO is personally engaged and socially responsible investment (SRI) began this trend. Storebrand said that one of the drivers for their reporting, certainly in the last five years, has been the board. The Chairman is also the chairman of GRIP[107]. Storebrand reports twice a year against its goals. The board wants to know how the goals will be met and if they didn't achieve the goals, why they didn't and what they will be doing to achieve them next time. Storebrand wants transparency and it is important to them to know how they are improving. The board has identified major issues of environmental risk. They have implemented SRI across all of their investments. It started with life insurance but has now moved to all investments including all asset management. Their general SRI criteria include human rights; serious environmental degradation; corruption; they exclude the 10% worst in the high impact industries; land mines / cluster ammunitions / nuclear arms; tobacco. Pursuant to these criteria, 70 companies have now been excluded. Storebrand also has specialized SRI funds. These take the top 30% in the best of sector.

This research from Norway together with the Australian research on the mandatory reporting provision has shown that the board has a crucial role to play in getting the company to integrate its environmental and social responsibilities and opportunities into their strategies. A section similar to the UK provision could well play this role. Criticisms of such an amendment being included in Australian legislation, range from it being unnecessary as simply a codification of the current common law, to not being a reflection of future concerns, although it does reflect current concerns. As to the first criticism, the argument for codification is for the legislature to clarify a particular area of the law rather than the courts (and the legislation would not depart from the current s181). Rather the section should be amended and clarified. As for the criticism of not reflecting future concerns, if the law can truly reflect current concerns, that would be a commendable achievement. If concerns change in the future, the law can be amended.

It is clear that as the law currently exists, under common law and ss180 and 181 *Corporations Act*, directors can take into account a range of factors external to shareholders if this benefits the shareholders as a whole. However, in terms of achieving better environmental performance of companies through a more active board of directors, the current law is inadequate, for the reasons explained above.

The CAMAC report, while acknowledging that companies need to consider the environmental and social impact of their conduct, states that as the current common law and statutory requirements are wide enough to allow directors to consider the environmental and social impacts of the decision, no amendments to director's duties under the Corporations Act were recommended. The report concludes that where the market wasn't enough to focus the company's mind on the environmental and social impact of business behaviour, specific legislation directed to the problem area was the

[106] Storebrand is Norway's largest insurance company and its three business areas are life insurance, banking and asset management.
[107] GRIP is funded 50% by the Ministry for the Environment, as an enabling agent on sustainable production and consumption for business.

solution. One advantage of this was that it would have wider coverage than the Corporations Act. In the context in which CAMAC set this conclusion – namely, where legal protection for social and environmental interests are needed - it is a reasonable conclusion. However, as noted above, specific legislation directed at the environmental problem areas is prohibitive rather than permissive and compliance does not mean that the company is proactively considering environmental issues in their decision-making. This seems to be a missed opportunity as companies have been slow in incorporating environmental and social issues into their decision-making.

v) Corporate disclosure:

Can corporate disclosure through reporting make companies more environmentally responsible? It has been said that the challenge is not about reporting, it is more about communication, engagement and learning.[108] The question is whether reporting or disclosure is effectively integrating sustainability into the thinking and practices of the company. If this is not currently the case, as has been suggested[109], then how can we get this to happen?

There needs to be the development of detailed guidelines for disclosures on responsibility, accountability and sustainability targets; boards have to start to think strategically about the competitive landscape in terms of risks and opportunities; and investors need to be interested in this information. SustainAbility has been looking at the nature of environmental reporting and has identified the international trends in this reporting. Ten years ago, they identified ten future trends in relation to corporate reporting[110]. Although radical at the time, many of these have been adopted by companies.

The predicted trends which are lagging include - the move to life cycle business models and strategies; the move from inputs and outputs to impacts and outcomes; the move to global operating standards; the move to mandatory reporting; and effective stakeholder dialogue. In terms of future international reporting, the Global reporting Initiative G3 guidelines are focusing on materiality and sector reporting rather than generic frameworks which should be more effective. Sustainability risk management is now expected and companies will be expected to report on sustainability opportunities as suggested by the carbon disclosure project.

There are a number of reporting provisions currently in existence in the *Corporations Act* 2001. This paper will consider three of them. Sections 299(1)(f), 299A and 674.

Section s299(1)(f) states that

[108] SustainAbility 2006 survey fn 26
[109] Ibid pp 6-7
[110] 1) one-way passive communication to multi-way active dialogue; 2) verification as standard; 3) single company progress reporting to benchmarkability; 4) management systems to lifecycles; 5) inputs and outputs to impacts and outcomes; 6) ad hoc operating standards to global operating standards; 7) PR to corporate governance; 8) voluntary to mandatory reporting; 9) boundaries set by companies to boundaries set by stakeholders; 10) environmental reporting to sustainability reporting.

"The Directors' Report for a financial year must:(f) if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory give details of the entities performance in relation to environmental regulation."

It has been one of the most controversial sections in the *Corporations Act* and its intention when it was introduced was to focus the minds of companies on environmental issues. For this reason the proponents of the original bill, introduced in 1998, insisted it be mainstreamed into corporations legislation rather than environmental legislation. Norway has a similar provision under their Accounting Act 1998, requiring companies to report in their director's report. Section 3.3 states,

"Information concerning current activities including production inputs and products that may cause a not insignificant impact on the external environment shall be provided. The actual and potential environmental impacts of particular activities shall be specific and the firm shall specify efforts initiated to eliminate or reduce negative environmental impacts."

Longitudinal studies looking at the performance of the top 100 companies have been done in both Australia and Norway and the results of these studies have been well documented.[111] The Australian research has shown improved compliance over the six years of the study[112]. The major findings were followed up through in-depth interviews with six Norwegian companies. This research found that for three of the companies, the mandatory reporting provision was the major driver for corporate social responsibility reporting. The companies were all asked whether they saw a connection between the mandatory environmental reporting requirement under the Norwegian Accounting Act 1998[113] and corporate social responsibility. Statoil replied that environmental issues were very closely related to CSR and the fact that reporting on the environment was obligatory may help make CSR and the link between these areas more visible, especially in relation to water resource management, discharges to the sea, and co-existence with other users.

Statoil said that the legal requirement had helped to highlight results and issues including making these issues more visible in the decision-making process. It said it had had a good effect on stakeholder response evidenced by the Dow Jones Sustainability index results over the last few years. NCC Construction Norway AS[114] was very positive about the effect of the mandatory reporting requirement. It said that the mandatory reporting

[111] Bubna-Litic, K & de Leeuw, L, (2000) "The Thin Green Line: 1999 Annual Reporting of Section 299(1)(f) Environmental Reporting" Faculty of Law UTS, ISBN 1863655832; Bubna-Litic, K, and Willamson, I, "The thin green line: embedded? 2002 annual environmental reporting under s299(1)(f) of the Corporations Law" (2004) 21 EPLJ 466; Jelstad, Janka, Gjølberg, Maria. Corporate Social Responsibility in Norway : An assessment of Sustainability Reporting by Major Firms in 2003 . Oslo: ProSus 2005; Audun Ruud, Janka Jelstad, Karoline Ehrenclou and Irja Vormedal 2005. Corporate Responsibility Reporting in Norway: An Assessment of the 100 Largest Firms. Prosus Report 09/05

[112] In 1999 71% of companies reported under s299(1)(f). in 2002, the result was 89% and in 2004, 95%.

[113] Similar to s299(1)(f) *Corporations Act* 2001 (Cth)

[114] NCC Construction Norway AS is a wholly owned subsidiary of the Swedish company NCC AB and is one of the five largest construction companies in Norway

requirement was a nice way to ensure that CSR, in terms of environment, is fulfilled in that as the legislation was very specific, it was helpful to have a law which gave details on how to report under it and particularly good in that there was a consistent standard for all companies, which was available for companies off the internet.

The Norwegian regulation differs from s299(1)(f) in that s299(1)(f) does not have detailed guidelines as to how to report. As to its effect on the company, NCC said that it helped NCC stay focused and that it was a useful tool to convince the company that environment is important. Kemira Chemicals[115] said that doing the mandatory environmental report was a motivator in making progress in this area. It said that the Accounting Act provisions did have an effect on how they reported under CSR and that the company reported and implemented changes in response to the mandatory reporting requirement under the Accounting Act.

One of the arguments in support of reporting is that it helps the company with its internal behavioural change. By having to report externally, a company, for the first time, may have to gather data internally which may help it understand where it is performing well and where there is room for improvement. This was borne out in the Norwegian research. Of the three smaller companies interviewed, both HAG[116] and Kemira Chemicals had reported extensively under the mandatory reporting requirements of the Accounting Act. In response to the question - why had they reported so well under this provision when the regulator was taking a hands-off approach, Kemira Chemicals said that the environment report was an important communications tool to inform their customers that they are trying to run their company with less risks and with more concern for the environment. Another for Kemira was their participation in a national competition focusing on environmental reporting. They also saw the report as a motivator for progress. HAG said they reported because it was mandatory and it was an opportunity to communicate what they did on a daily basis.

However, for reporting to be effective, there needs to be specific guidance. There needs to be methods of measuring non-financial criteria, together with standardised reporting criteria to enable comparisons across industries, for a start. The GRI is good on this, but not many Australian companies are voluntarily reporting under the GRI. The mandatory reporting requirement has almost all of the top 100 Australian companies reporting but the Australian research has identified that only the reporting in categories four, five and six[117], would be classified as comprehensive reporting. This indicates that s299(1)(f) is vague and herein lies an opportunity for ASIC to develop best practice guidelines.

Consider the chart below which shows which sectors are reporting comprehensively under the mandatory provision.

[115] Kemira Chemicals produces chemicals for water –treatment and pulp and paper industries.
[116] HAG is an office chair manufacturer
[117] Category four includes comprehensive details of positive environmental activities. Category five includes category four information with the addition of details of non-compliance or recognition by the company that even if there has been no non-compliance with regulation, there may still be negative impacts from a company's activities. Category six contains category five information plus a mention elsewhere in the Annual Report or in a separate report, referred to in the director's report.

Sector	% reporting in categories 4, 5 or 6
Building	100
Property Trusts	13
Investment	0
Finance	13
Communications	0
Media	0
Gaming	34
Energy	60
Resources	92
Retail	50
Vitners and brewers	67
Transport	13
Health and Pharmaceuticals	34
Diversified Industrials	73

The sectors in need of improvement are the investment, communications and media sectors as well as the property trust, finance and transport sectors, but in all of the latter three sectors, there are leaders. There were best practice companies which scored a six. These were General Property Trust (GPT), ANZ (Finance) and Brambles (Transport). These could all be used as best practice cases for that sector.

ASIC should also use some of these best practice examples in each sector to draw up sector specific guidelines. In addition to prescribing details of how companies should report under section 299(1)(f), there needs to be a strengthening of enforcement on ASIC's part. In terms of auditing requirements under the Corporations Act 2001, the director's report is not audited but there are civil and criminal consequences for false or misleading statements by the directors.

CAMAC looked briefly at s299(1)(f) *Corporations Act* and concluded that mandatory reporting would lead to a tick box culture of compliance, however, the follow-up research in Norway contradicts this conclusion and has indicated that the mandatory reporting requirement is a driver for some companies.

CAMAC preferred to endorse s299A *Corporations Act* which requires the director's report to include information that the shareholders would reasonably require to make an informed assessment of the operations and financial position of the company and its business strategies and its prospect for future financial years. This section has applied to Australian companies since 2005. It was a response to the HIH Royal Commission report and it followed along the lines of the UK proposals for an OFR[118] which provided that

[118] UK Operating and Financial Review

directors should report on what is necessary to obtain an understanding of the business, including details of the company's performance, plans, opportunities, corporate governance and management risks. Section 299A has the potential to capture information on environmental and social performance and it is intended to be more prescriptive than s299(1)(f), but the jury is still out on whether there is any change in the quantity or quality of reporting. More important is whether this type of reporting will make any changes to the way the company performs in terms of its environmental performance. This remains to be seen.

What is the role of the auditor with respect to these mandatory reporting provisions? Contingent liabilities must be reported in the financial reports[119] which would, of course, cover contingent environmental liabilities and would have to be audited. The director's report does not have to be audited. Nevertheless, auditors are under an obligation to read non-financial information in the director's report to be able to identify material inconsistencies with the audited financial report and then have to report on this.[120] This would apply to environmental disclosure under s299A and s299(1)(f), even though environmental disclosure is not specifically mentioned in the accounting standard[121]. Perhaps in order to drive quality into environmental reporting, there should be a requirement that this reporting be audited. In order to do so, the reporting requirements and indicators would need to be specified.

Continuous disclosure provisions, requiring disclosing entities to disclose any material information immediately to the market were introduced following a parliamentary committee inquiry in 1991.[122] In response, the predecessor to Ch 6CA (ss674/675) was introduced in 1994. The continuous disclosure provisions under s674 *Corporations Act* 2001 and 3.1 ASX listing rules require listed companies to report immediately to the ASX any information that a reasonable person would expect to have a material effect on the price or value of the entity's securities.[123] If the test for materiality was satisfied, this would include environmental and social issues. For example, investors would want to know what provision a company may have made to adapt to the effects of climate change, such as increased energy costs or increased fuel prices.

The effect of s674 is to create a legal structure of a shared regulatory role with respect to listed companies, under which ASX specifies continuing disclosure requirements and monitors compliance with them and ASIC takes enforcement responsibility with respect to breaches. If a company has not complied with the listing rules, can an aggrieved person seek judicial review? With respect to the listing rules, it has been said that s

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[119] Australian Accounting Standard AASB 137 to apply from 1 January 2005, implementing International Accounting Standard IASB 37

[120] AUS *Other Information in Documents Containing Audited Financial Reports* (October 1995)

[121] See fn 51

[122] Companies and Securities Advisory Committee, *Report of an Enhanced Statutory Disclosure System* (1991), pp 9-10; see also M Blair (1992) "The Debate Over Mandatory Corporate Disclosure Rules" 15(1) UNSWLJ 177; see also Australian Securities Commission, *Enhanced Statutory Disclosure System: A Response to the Companies and Securities Advisory Committee Report* (1992), p 8.

[123] For unlisted disclosing entities, under s675 the *Corporations Act* specifies the disclosure obligations and ASIC has responsibility for monitoring compliance with and enforcement of these statutory obligations.

793C(2) was introduced to enable the Court to make orders against directors of a company that is under an obligation to comply with a rule, even though those directors are not personally obliged by the rule. That provision does not expand the scope of the directors' obligation to comply. It means that where a company has been ordered to comply with the listing rule, the directors would be willing to implement that order.[124] Under this section, the court has power to order compliance with the listing rules on the application of ASX, ASIC or an aggrieved person. There is some leeway within the ASX's discretion in enforcement as its primary concern is for underlying principles rather than the letter of the rules and there is little prescription in terms of what to include in complying with the rules. Perhaps enforcement of the listing rules should be in the hands of an independent body, such as ASIC, rather than ASX which, arguably has a conflict of interest in enforcement of compliance with the listing rules.

There has been only one incidence of reporting under this provision in the past five years and this was Santos which disclosed an environmental incident under this provision.[125] The incident involved a mud flow from the Banjar Panji exploration well in Indonesia.

Santos holds an 18% participating interest in the Brantos production sharing contract and the relevant joint operating agreement. As a result of the incident approximately 3300 families and businesses had to be moved as the land was no longer fit for human habitation and the mud containment area needed to be strengthened and the impact of the mud flow mitigated. In its report to the ASX, Santos originally estimated its share of the total remediation to be around $24.3m but had to revise this up to $43m in light of increased estimate in costs by the operator. This may of course go even higher. The fact of such little reporting on environmental liabilities under the continuous disclosure provision, is a good indicator that companies will continue to report in the future, only when and if the incidents attract media attention.

Part of the current problem with voluntary disclosure is that with Australian companies, the standard is pretty poor. Take, for example, the carbon disclosure project,[126] a global project under which reports are published annually. It is the largest registry of corporate greenhouse gas emissions in the world. Although 57% of the top 100 Australian companies did respond to the survey, the quality of reporting was poor. For example, few companies fully quantified and verified emissions and most emission reduction initiatives did not have clearly defined targets or timelines. In a recent comparison between Australia and Norway on mandatory reporting[127], the author found extensive quantifying data on emissions in Norwegian companies' reporting under the mandatory reporting provisions. There seems to be a real reluctance on the part of Australian companies to give this detailed information. What incentives would encourage this change of behaviour?

[124] Redmond, P, Companies and Securities Law Commentary and Materials Law Book Co. 2005 at ch 11
[125] Disclosure was on 19 October 2006
[126] www.cdproject.net
[127] Bubna-Litic, K (2006) fn 96

ASX listed companies must provide a review of operations and activities for the reporting period.[128] Amongst other requirements, it provides that the review should include discussion and analysis of key financial and non-financial performance indicators from multiple perspectives such as sustainability measures including social and environmental performance measures, where relevant.[129] The ASX Corporate Governance Council is currently investigating whether it has a role in corporate responsibility reporting[130] which would include the disclosure of environmental and social risks. It has set out guidelines on recognizing and managing risk.[131]

The US has extensive mandatory reporting requirements under its Securities and Exchange Commission (SEC)[132] but they only relate to information that is material. In the US 'material' has been defined as limiting the information to matters where there is a substantial likelihood that a reasonable investor would attach importance in determining to buy or sell the securities[133] and the 'reasonable investor' test has been interpreted to limit the disclosure obligation to any information that is likely to have an immediate effect on the share price.[134] SEC Item 101 refers to the filing of a general description of a company's business and this must include information about the material impact that environmental regulations will have on the registrant's capital expenditures, corporate earnings and general competitive position, including capital expenditures for environmental control facilities.

SEC Item 103 provides for mandatory disclosure, on a quarterly basis, of any actual or pending administrative or judicial proceedings under federal, state or local environmental laws, if the proceedings are material to the business or financial condition of the company or if the relief sought is more than 10% of the company's current assets, or penalties would amount to more than US$100,000. SEC Item 303 requires disclosure in terms of an analysis of any trends or uncertainties that the company reasonably expects will have a material (both positive and negative) impact on net sales or revenues or income from current operations.[135] Although this doesn't specifically mention the environment, the US EPA has, in an enforcement alert, stated that

> …..full and fair disclosure of material information related to a firm's environmental performance, compliance and liabilities is essential if stock markets are to accurately reflect the financial condition of publicly traded companies.

The EU has passed a directive which mandates minimum standards on disclosure of environmental matters in company annual reports.[136] France has enacted legislation that

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[128] ASX listing rule 4.10.17
[129] Guidance note 10 of the ASX listing rules
[130] ASX Corporate Governance Council Consultation Paper *Review of the Principles of Good Corporate Governance and Best Practice Recommendations* (November 2006)
[131] Principle 7 *Principles of Good Corporate Governance and Best Practice Recommendations*
[132] Items 101, 103 and 303 of Regulation S-K
[133] Securities and Exchange Commission (SEC) reg 240.12b-2
[134] CAMAC report p126
[135] para (3)(ii)
[136] *EU Accounts Modernisation Directive* (June 2003) for financial years commencing January 2005.

goes further than the directive[137]. Under Section 116 *Nouvelle Regulations Economique* (NRE) it is mandatory for all quoted companies to include in their annual report all information on how they take into account the social and environmental consequences of their activities. This came into force in 2003. Companies in France must report on their use of water and natural resources, their emissions of greenhouse gases and energy consumption, and what efforts they have undertaken to reduce environmental risks and to educate employees about environmental management.[138] The first review of this legislation found that only companies which were exposed to an environmental hazard reported on the environment.[139] The reviewers concluded that the value of the legislation was that the companies were made aware of the issues. [140] It found that not all companies were complying with the law and suggested that the government should find out why before applying penalties to those companies.[141]

The report suggested that there needed to be clarification by the government stressing that the law is aimed at investors[142]; clarification of the geographical scope, such as where there is group of companies[143]. The company should identify what is relevant and choose their own indicators[144]; and the company should adhere to an international reporting framework[145]. The report found that it was premature to amend the law and there needed to be time to properly evaluate the successes and failures of the law.[146]

The UK is an interesting example as it has had a Minister for Corporate Social responsibility for some time and it has been talking about legislating in this area since 2004 when it introduced the CORE Bill. In more recent times[147], the UK introduced a mandatory operating and financial review (OFR) into their director's reports for their reporting year beginning April 2005. By the end of 2005, this had been discontinued. The proposed OFR would have gone beyond the EU Directive requiring companies to set out information concerning resources, risks, uncertainties and relationships that may affect the long-term value of the company. This would have included reporting on the environment as well as social and community issues.

The new UK Companies Act 2006 adds a requirement less stringent than the OFR. It provides that companies must include in their director's report a business review, which must contain a description of the principle risks and uncertainties facing the company. It must include environmental matters and social and community issues to the extent necessary for an understanding of the business. This is somewhat different to the OFR

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[137] *Nouvelle Regulations Economiques* (No 2001-420) (NRE)
[138] EIA country analysis briefs. http://www.eia.doe.gov/emeu/cabs/franenv.html accessed 12 December 2006
[139] http://www.orse.org/site2/maj/phototheque/photos/docs_an/critical_review....pdf p.12 accessed 6 February 2007
[140] ibid p.45
[141] ibid.
[142] ibid.p48
[143] ibid.
[144] ibid p49
[145] ibid.
[146] ibid p54.
[147] March 2005

which focused on the company's long-term value. Another difference is that the high level of audit check required under the OFR is not included.

In South Africa, countries listed on the Johannesburg Stock Exchange (JSE) are required to report annually on their environmental and social performance.

CAMAC had to consider whether the *Corporations Act* 2001 should be amended to mandate disclosure on social and environmental issues. It has taken a very conservative view. It concluded, on rather shaky grounds that the *Corporations Act* is apt for drawing out information relevant to a company's business performance and prospects but it shouldn't be used to achieve disclosure that goes beyond its underlying rationale, which is to meet the needs of its investors rather than the wider community[148]. This would tend to exclude future investors who are, indeed, the wider community. The role of institutional investors was also investigated and it was noted that they were 'increasingly considering non-financial factors' but one of the limiting factors was the deficiency in non-financial information. There was a recognition that there needs to be better reporting, which this paper has argued could be enhanced by ASIC giving guidelines with best practice case studies.

CAMAC argued that s299A *Corporations Act* was an appropriate platform for the disclosure of non-financial information, it being capable of triggering disclosure on environmental and social issues which impact on the company's business. But it is the realising of this potential which causes most concern. There are a number of provisions that could facilitate disclosure by companies on matters that would be material for investors. These provisions had the potential to encourage companies to report on their environmental impact but it has not had this effect. The CAMAC report argued that it was too early to prescriptively legislate for non-financial disclosure as these disclosures are still evolving internationally. The report favoured a voluntary initiative like the GRI but thought it was too early to recommend it as a voluntary Australian framework. Why, when internationally, companies are embracing it? As the KPMG surveys and other international surveys such as the Carbon Disclosure project have shown, Australia is a laggard in terms of voluntarily reporting on companies' social and environmental performance. There have always been some top performing Australian companies in this regard, but generally Australia performs poorly.

Where is the evidence to support the optimistic view of CAMAC that Australian companies will use s299A *Corporations Act* to report on environmental and social issues when there is no mandatory requirement to do so under this section? They do comply well with s299(1)(f) where they are mandated to report on their environmental performance, although there are also shortcomings with this section.[149] CAMAC also recommended that reporting more widely than for the purpose of protecting investors, should be done in legislation other than in the Corporations Act. However, once you have

[148] CAMAC report p.145
[149] Though I would argue that this is more to do with the lack of guidance of what information would be useful to report under s299(1)(f)

reported in a piecemeal way, as would follow from this suggestion, the value of reporting begins to diminish.

If the purpose of disclosure of non-financial matters is for stakeholders to be able to evaluate and respond to the way business is being conducted, as well as an internal tool to focus corporate managers on these non-financial matters, then the most efficient way is for this information to be disseminated in one document, the annual report, and for the requirements to be set out in one piece of legislation, the *Corporations Act*. The ASX Listing Rules and Corporate Governance Council principles have the potential to get companies to disclose environmental and social risks and are currently undergoing a review of what role the Council should have in CSR reporting. Perhaps this will be the way forward for Australian companies, although this would only apply to those companies listed on the Australian Stock Exchange. There is an argument that all companies should be focusing on their environmental performance.

The incentives for responsible practice

Both the CAMAC report and the parliamentary report concluded that legislative reform is unnecessary and that voluntary initiatives and the market were up to the task. If mandatory disclosure is not the way to go, then perhaps incentives are the way to encourage responsible corporate practices. In 2003, Australia introduced a standard on corporate social responsibility[150] and the federal government released guidelines for triple bottom line reporting[151]. Even with these, despite some tweaking at the edges, generally good corporate environmental practice is sporadic. Perhaps, to date, the mechanisms in Australia have not been the right ones?

There are various international codes principles and guidelines dealing with responsible corporate conduct such as the OECD Guidelines for Multinational Enterprises (2000)[152], which includes environmental protection, the UN Global Compact (2000) and the Global Compact Cities Programme (2003)[153]. Focusing on the financial and investment communities there are the UN Environment Program Finance Initiative (2003), a voluntary p/ship between the UN and the financial sector to promote the best environmental and sustainability practice and the UN Principles for Responsible Investment (2006) where pension funds undertake that they will take into account whether companies meet certain environmental standards, in their investment decisions. It may be illustrative to see how many Australian companies are voluntarily signatories to these codes.

The OECD guidelines can only be signed by nation states and Australia has established the Australia National Contact Point (ACNP) to help implement the guidelines. Westpac and NAB are two companies that have endorsed the guidelines and reported on their compliance. The Global Compact has 2,500 participants worldwide, 25 of which are

[150] AS 8003-2003
[151] http://www.environment.gov.au/settlements/industry/finance/publications/indicators/pubs/indicators.pdf
[152] www.ausncp.gov.au/content/text.asp?areaid=9
[153] Melbourne is the only Australian city participating in the program.

Australian companies.[154] Eleven of these companies are small and medium enterprises (SME's) and four are academic institutions. The UNEP Finance Initiative[155] requires financial institutions, such as banks and insurance companies, to commit to the integration of environmental considerations into all aspects of their operations. As of 9 January 2007, 168 financial institutions from thirty six countries are signatories to the initiative. Of these, nine are Australian.[156] The UN Principles for Responsible Investment (2006) focus more on the investment community with three categories of signatories. These are asset owners[157], investment managers[158] and professional service partners[159], and Australian organisations are some of the first to sign up, with the asset owners being superannuation funds.[160]

In addition to these guidelines, there are international organizations that promote responsible business practices, innovation and collaboration. These include the Business for Social Responsibility[161], the Coalition for Environmentally Responsible Economies (CERES)[162] principles, the Equator Principles[163] for financial institutions, and the Responsible Care Global Charter[164] for the chemical industry. The only one of these to which Australian companies have subscribed is the Equator principles and the relevant Australian companies are ANZ and Westpac. According to Westpac, the total number of signatories to the Equator Principles cover more than 80% of the global project-financing market.

The role of suppliers shouldn't be underestimated in achieving responsible practice.[165] The Norwegian research found that suppliers can be quite influential. NCC, Savo, and HAG saw it as crucial. NCC Construction saw the potential for better environmental performance through their supplier relationships. They have a list of harmful substances which they require their suppliers not to use. In Dec 2005, they decided not to use rainforest timbers in their construction. They used the Rainforest Foundation, a Norwegian organization's website to determine which timbers they can use. They tried to educate their clients and suppliers. However, their monitoring needed to be improved. In 2005 they had 35 internal audits but only 4 on sub-contractors. This is an area they have identified for improvement.

Savo have introduced a number of measures to reduce the ecological footprint of their products, though they are at the beginning stages. They have reduced the number of

[154] As at 7 January 2007 www.globalcompact.org
[155] www.unepfi.org
[156] These are Westpac, VicSuper, Savings and Loans credit Union (SA) QBE Insurance Group, NAB, Medibank Private, mecu, IAG, ANZ.
[157] Out of 56 in total, 10 are Australian
[158] Out of 52 in total, 4 are Australian
[159] Out of 34 in total, 5 are Australian
[160] www.unpri.org/signatories/#im
[161] www.bsr.org
[162] www.ceres.org
[163] www.equator-principles.com
[164] www.responsiblecare.org
[165] See de Leeuw, L, Bubna-Litic, K and Genoff, R, Implementing the Green Advantage in Small and Medium Sized Enterprises A City of Playford Council Report, Oct 2001

components in one of their chairs from approximately 140 down to 60 and are using aluminium and moulded plastic instead of steel. Almost all of the aluminium is recycled and the aluminium is lighter. They are reducing the use of screws in favour of snap on / snap off technology which will require no tools and the time required to assemble the chair is one tenth of other chairs. The environmental focus begins early in the design process. The manufacture of Savo's chairs is sub-contracted out. Environmental focus is one of the criteria for tendering by suppliers and as an example, the suppliers of fabric are asked to declare how their materials are produced. HAG sets out its environmental criteria before the design begins and then it is put into an environmental product declaration which is lodged with NHO[166]. It is crucial to HAG to have their suppliers in line with its environmental objectives. Initially suppliers were not interested but HAG then explained that if they didn't change, they would no longer be using them.

Case study: climate change: Will this be the ultimate driver for companies?

The Stern Report[167], released in 2006 set out some forecasts in terms of the economic implications of climate change. The Stern Report was the result of an independent review commissioned by the UK Chancellor of the Exchequer reporting to the Chancellor and the PM on assessing the evidence and understanding the economics of climate change. According to Stern, reducing emissions must be seen as an investment, a cost which will need to be incurred now to avoid the risk of very serious consequences in the future. If this is done, then costs will be manageable and coupled with these costs will be opportunities for growth and development.[168]

The action on climate change includes mitigation, innovation and adaptation. "The challenge is to deepen participation across all the relevant dimensions of action – including cooperation to create carbon prices and markets, to accelerate innovation and deployment of low carbon technologies, to reverse emissions from land-use change and to help poor countries adapt to the worst impacts of climate change."[169] Policy must play an important role in this promoting of sound market signals, overcoming market failure and have equity and risk mitigation at its heart. Ideally this will need a whole of government approach.

Environmental policy is the driver but the necessary economic and financial policies will be mainly implemented through corporate law, environmental law and taxation law. The report suggests that ignoring climate change will eventually damage economic growth. There is a need to decarbonise both developing and developed countries to stabilize climate and maintain economic growth. To stabilize at 450ppm CO_2e we need to peak in the next 10 years and then fall by 5% annually to reach 70% below current levels by 2050. The cost of stabilizing at 500-550ppm is 1% of GDP per year. About 70% of the

166 The Confederation of Norwegian Business and Industry
167 http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm accessed 17 January 2007
168 Stern Report exec. Summary i.
169 ibid xxvii

power sector will have to be decarbonised by 2050 to stabilize at or below 550ppms. The cost of not stabilizing at this level is between 5-20% GDP.[170]

Emissions can be cut in four ways:

- Reducing demand for energy intensive goods and services;
- Increasing efficiency;
- Action on non-energy emissions eg avoiding deforestation (1/3 of emissions);
- Low-carbon technologies (which must be competitive with fossil fuels on cost) for power, heat and transport.

The three cornerstones of emission reduction policy are a carbon price, technology policy, and the removal of barriers to behavioural change. Pricing carbon is simply the pricing of an externality that is causing climate change resulting in the producer of the carbon paying the social cost of their actions. The appropriate price can come from tax, trading or regulation. It is ideal to have a global carbon price and by pricing carbon, this will encourage individuals and businesses to move towards low-carbon products and services. Carbon pricing must eventually be automatically factored into decision-making. Carbon pricing offers an incentive to invest in technologies to reduce carbon but companies must be confident that a carbon price will be maintained into the future. Regulatory and policy certainty is essential.

In terms of barriers to behavioural change, regulation can play an effective role. Minimum standards for buildings and appliances as well as labeling (star ratings) will improve energy efficient performance. Fostering a shared understanding of climate change and its consequences is crucial in shaping behaviour.[171] So governments should support education and discussion that is supported by evidence.

Adaptation is making cost effective decisions which will reduce the impact of climate change such as developing climate resistant crops and building sea walls in low lying areas. Policy support in this area will include high quality climate information and tools for risk management; land-use planning and performance standards to encourage investment in buildings and other infrastructure to take account of climate change; a financial safety net for the poor in society who are least able to afford protection, such as insurance; strong natural resources and coastal protection.[172] International coordination of regulations and product standards can raise their cost effectiveness, strengthen incentives to innovate, improve transparency and promote international trade. Systems of international cooperation to accelerate technological innovation will reduce the costs of reducing emissions. Reducing tariff and non-tariff barriers for low-carbon goods and services particularly with the Doha round of WTO negotiations will provide more opportunities for cooperation.[173]

[170] ibid x
[171] ibid xxi
[172] ibid xxii
[173] ibid xxv

For a business, it is largely irrelevant whether or not the science on climate change is correct. International and national political and economic systems are taking decisions on the assumption that it is correct. This is the environment that business now has to work with. As Greg Paramor, the managing director of Mirvac Group recently said, "All of a sudden global warming has hit Main Street, it's now a business issue".[174] Australia has mixed initiatives to get companies to respond to the challenges of climate change. Australia has not ratified the Kyoto Protocol but has recently established the Asia-Pacific Partnership on Clean Development and Climate (AP6)[175]. However, in May 2006, the US House of Representatives blocked the allocation of AP6 funding.[176] In 2001 the federal government established a national Mandatory Renewable Energy Target (MRET) which required 9500 GWh of renewable energy to be generated in Australia annually. This encouraged companies to implement established renewable energy technologies and this target was met by 2004. However the target has not been increased since 2001 and so this very successful initiative has been left to die.

The Australian Greenhouse Office has established a number of voluntary schemes but there is no National Trading Emission Scheme. Recently, The Coalition of Australian Governments (COAG) agreed on legislation to introduce a uniform and consistent framework for industry to mandatorily report on greenhouse gas emissions and energy use.[177] COAG proposes 'national purpose-built legislation' to provide for cost-effective mandatory reporting and disclosure on energy consumption and greenhouse gas emissions at the company level. The framework will provide for streamlined reporting of greenhouse and energy data. This is a positive step with regard to climate change issues which may trickle down into other aspects of environmental issues. The Australian states have been more active. In NSW the NSW Greenhouse Gas Abatement Scheme (GGAS) came into effect in early 2004. Queensland has introduced a scheme promoting the use of gas for electricity in 2005[178] and in 2006 South Australia has proposed a GHG reduction target of 60% below 1990 levels by 2050 and a renewable energy target of 20% by 2014[179]. Victoria has a renewable energy target of 10% by 2016.

At the moment, one of the barriers for businesses to invest in climate change infrastructure and innovations is regulatory uncertainty and that it is why it is crucial for the federal government to put a price on carbon and to give certainty to investors on their climate change policy.

Conclusion:

The big issue is how corporate behaviour can be less environmentally damaging. Do we need a carrot approach or will the stick be good enough? Who should be offering the carrots? Will the corporation consider environmental and social issues because its

[174] 'The right climate for hot money' Australian Financial Review, 17 June 2006
[175] This was established in July 2005 with the US, China, India, Japan and South Korea.
[176] CDP Report 2006, p27.
[177] www.greenhouse.gov.au/reporting/pubs/ris.pdf
[178] Ibid p28
[179] Climate Change and Emissions Reductions Bill 2006 introduced into the South Australian parliament on 6 December 2006.

shareholders want it to? Is it a role for other stakeholders; or is the best group to effect change, the board of directors? If it is the board of directors who, after all, are the managers of the company, then what will drive the board of directors to effect this change?

As the current government seems unwilling to mandate legislative changes to director's duties, perhaps the courts, through activist shareholders, may play a role in a liberal interpretation of director's common law duties. Continuous disclosure to both the ASX and through company annual reports should have a strengthened role but whether or not there is new legislation, similar to the UK or French laws, or whether ss299(1)(f) and 299A *Corporations Act* are the provisions to be used, there needs to be guidance similar to the Norwegian Accounting Act and best practice industry examples to engender comparative data across industries and to make the information disclosed meaningful.

It is really a matter of getting the incentives right. The big stick rarely works and the danger is that some companies will see more regulation as merely an opportunity to tick the box. Something to encourage directors to look at the long term viability of the corporation is needed. Perhaps climate change will offer the incentive needed for a wider spread of companies to become more environmentally and socially responsible. A critical mass of companies can use their procurement policies to bring others on board.

As this paper has pointed out, companies must report on contingent liabilities in their financial information which has to be audited. They must also check on non-financial information to the extent that it affects their financials. There are real questions of liability if companies do not start to recognise and manage the risks inherent in ignoring environmental and social issues. Companies really do have to incorporate the management of environmental risks into their overall strategy and many are already doing this.

The trends for reporting seem to be that over the last five years, the issues of risk and compliance have been taken for granted and are being addressed. I suggest that companies will start to recognise the tangible opportunities that exist for companies that are aware of the environmental and social dimensions of their businesses. These are the companies that will make the big gains in the future and these gains will be through innovation. We will soon see a shift from just environmental risk management to seeking environmental business opportunities, as well as managing environmental risk.

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