RTBU

A social licence that means something

Restoring public faith in Australia's scandal-ridden corporate sector

December 2018

Introduction

This discussion paper does four things.

Firstly, it provides a brief survey of recent examples of corporate misconduct and misbehaviour in Australia.

Secondly, it outlines the historical basis that underpins corporations' responsibilities to the public interest and societal expectations.

Thirdly, it explains how the existing laws have moved away from the traditional purpose of corporations, to the detriment of workers, the community and the environment – and to corporations themselves.

Finally, the report makes recommendations for government policy to address these problems.

About the RTBU

The Rail Tram and Bus Union (RTBU) is an all grades industrial union comprising 35,000 members in the rail, tram and bus industries Australia-wide. The RTBU was formed in 1993 following the amalgamation of three previous rail unions together with the tram and bus employees union. The RTBU is organised on national, state and divisional lines and is well unionised with over 85% of employees being a member of a trade union.

Executive Summary

Skim through the annual report or website of any major Australian company and you will be sure to find entire sections about its commitment to corporate social responsibility - donations to charities, environment and sustainability projects, and employee payroll giving programs.

So how can we reconcile the growing number of corporate social responsibility programs with the rise in corporate scandals and misbehaviour?

Consider the following:

According to AMP's latest annual report, its philanthropic arm, the AMP Foundation, "has distributed over $91 million to help charities and individuals made a positive impact on communities" since 1992. While donating to charity, the company was also charging customers fees without providing any services – and lying to ASIC about it. AMP has subsequently admitted it prioritised profit over compliance with the law.

Rail operator Aurizon has a Community Giving Fund that provides grants of up to $20,000 to charity or community group projects each year. In 2015, the company provided grants to 22 organisations. That same year, it terminated 12 enterprise agreements which led to 5,000 employees losing up to $20,000 in pay, job security provisions and a long-list of negotiated conditions, including parental leave. Aurizon's Statutory Net Profit After Tax for that financial year also increased by 139 per cent.

7-Eleven's website boasts it has "quietly supported many organisations raising and donating significant funds for Australian and overseas charities." At the same time as making these donations, the company has also quietly gone about underpaying it workers more than $150 million.

These corporate programs are simply ambulances at the bottom of the cliff. The irony is, the corporations are the reasons the ambulances are needed in the first place.

The question is why does it occur, and what can we do to stop it from happening?

The problem is corporate social responsibility has no teeth. It is treated as an 'add on' to the core business of corporations, which is presumed to be maximising profit for shareholders.

Although there is some scope for company directors to consider the interests of broader stakeholder group interests (employees, the environment, integrity of public services), this is largely left to the self-regulation of individual companies. As a result, corporate social responsibility often becomes a marketing tool, utilised by businesses that also cause harm to the community and environment.

And the dangers of not acting are growing. Business is encroaching further and further in the provision of basic public services historically provided by government and not-for-profit organisations. The RTBU believes these services should never have been privatised. In the event that privatisation cannot be reversed, however, it remains a serious concern that the directors of these companies have no legal duty under the Corporations Act to consider the impact of their business on wider stakeholders.

This discussion paper argues that the growing number of corporate scandals is a result of a regulatory system that facilitates the pursuit of profit above all else. Enough is enough. The public good must once again be at the core of corporate activity and as such, corporate regulation.

We call for changes to Australia's legal and regulatory system, including amending the Corporations Act to include corporate social responsibility or an explicit obligation for directors to consider the interests of stakeholders as well as shareholders. Changes should also be made to law of standing, the Objects of the Corporations Act and mandatory public reporting requirements.

We also call for the establishment of a new Australian Corporate Governance Authority (ACGA), an independent and research-based reform body to advise the Australian Government on these issues and lead the implementation of these important governance reforms.

We expect this proposal to be met with vocal opposition from elements of Australia's corporate elite. The reality is, however, nothing in this proposal is radical.The current chair of the National Australia Bank and former Secretary of the Treasury, Ken Henry recently told the Financial Services Royal Commission:

"The consequences of corporate activity go well beyond impacts on shareholders, and, yet it's only shareholders to whom, at law, the directors are accountable. In my view, the public tolerance of that model of accountability has been pretty well eroded to zero."

When later asked whether he believed "boards should be accountable to our community now and our future community," Dr Henry replied: **"I do, indeed."**

Recommendations

Directors' duties

Section 181 of the Corporations Act 2001 should be amended to include corporation social responsibilities and explicit obligations for directors to consider the interests of stakeholders, as well as shareholders:

A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the best interests of the corporation; and
(b) for a proper purpose; and
(c) with regard (among other matters) to:

> *(i) the impact of the corporation on the environment, the protection of aquifers, viable agricultural land and endangered species and the production of non-biodegradable waste material;*
>
> *(ii) the obligation to pay the full amount of corporate tax;*

(iii) the interests of the corporation's employees;

(iv) the interests of the corporation's contractors and suppliers;

(v) the impact of the corporation's operations on the community in which it operates; and

(vi) the interests of the corporation's consumers.

Standing to enforce

Expanding directors' duties raises the issue of how aggrieved stakeholders can enforce the corporate social responsibilities obligations on directors. To that end, the recommendations from the Australian Law Reform Commission's 1996 report, *Beyond the Doorkeeper: Standing to Sue for Public Remedies* are a valuable reflection point for policy makers.

The Commission's recommendations, none of which have been implemented, relate to specific proceedings relating to matters arising under the Constitution (or involving its interpretation) or federal legislation or are against the Commonwealth or a person acting on its behalf, and include:

- The adoption of a new, single and simple test for standing, to replace the wide range of existing tests;
- Removing the requirement for a person to have a "special interest" to commence proceedings;
- Enabling any person to be able to commence and maintain public law proceedings, unless the relevant legislation provides otherwise or the litigation would unreasonably interfere with the ability of a person having a private interest in the matter to deal with it as he or she wishes; and
- Enacting a Commonwealth standing statute to implement the Commission's recommendations.

Importantly, the Commission clearly stated that these changes will not lead to an increase in vexatious or frivolous claims and litigants. Courts have a number of mechanisms to manage the litigation process and to strike out matters for showing no cause of action or for being an abuse of process.

Directors who fulfil their duties to a corporation's shareholders and stakeholders have nothing to fear from reforms to the law of standing.

Ultimately, any changes to the laws of standing and intervention must be developed as part of the package of reforms for improving the accessibility and effectiveness of the legal system.

Personal liability of directors

In order to give real teeth to corporate social responsibility, the threshold for holding directors to account for breaches of the law should be lowered. Current tests for holding directors personally to account are too high. The Corporations Act should be amended to establish a positive obligation for directors and other officers to make reasonable enquiries about and to prevent reckless, intentionally dishonest and illegal behaviour.

If serious misconduct, such as systemic wage theft or environmental pollution is taking place, the test for directors should be straightforward - either they knew about it and are therefore responsible, or they didn't know about it and therefore failed in their duties.

Purpose of corporations and the Objects of Corporations Law

The Corporations Act should have an overarching Objects clause that clearly states the purpose of the Act is to ensure that corporate activity carried out in Australia is in the public interest. Company constitutions should be mandated to include a clause restricting companies from engaging in behaviour that would seriously harm the public interest, taking into account the effect of its behaviour on employees, the environment, taxation obligations and so on.

Public Interest Tests and Mandatory Public Reporting

The bigger the company, the bigger the impacts its activities have on the wider community. Once a company is large enough to have a serious impact on the community, its continued existence, with all the privileges that incorporation entails, should be conditional on that company's performance on a public interest scorecard.

Therefore, the Act should be amended to implement a public interest independent audit process for companies over a certain value. The audit would assess the company's performance across a range of benchmarks, including:

- Conditions for workers, including along the supply chain, gender pay gay, breaches of industrial instruments;
- Environmental impact; and
- Compliance with taxation obligations.

These audits should be conducted in the same manner as financial audits and made publicly available. Restrictions and penalties should be placed on the continued registration of repeat offender companies.

Role of ASIC

The Australian Securities and Investment Commission Act 2001 should be amended to ensure it has the powers to enforce corporate social responsibilities and respond to breaches.

Australian Corporate Governance Authority

A new Australian Corporate Governance Authority (ACGA) should be established. A key part of ACGA's mandate will be to help ensure the changes in law translate to real, tangible and cultural change in Australia's corporate boardrooms. ACGA will also have an important research-based and corporate education function. This includes advising Governments about other changes, and support corporations to fulfil their social responsibility obligations. The Authority's functions are, on its own initiative or when requested by the relevant Minister, to advise about any matter connected with:

(a) a proposal to make legislation or to amend legislation relevant to corporations;

(b) the operation or administration of legislation relevant to corporations;

(c) law reform in relation to legislation relevant to corporations;

(d) corporate governance; and

(e) corporate social responsibilities.

Corporate misconduct and misbehaviour

A corporate regulatory system that facilitates the pursuit of profit above all else has severe consequences. Corners are cut, and other important interests are disregarded. While there are too many examples to document here, a brief survey is provided below.

Wage Theft and Labour Relations

In its review into corporate avoidance of the *Fair Work Act 2009* (Cth), the Senate Standing Committee on Education and Employment found that the underpayment of wages to employees in some sectors of the Australian economy 'can no longer be considered an aberration; it is becoming the norm.'[1] As the Committee stated, wage underpayment by Australian employers has become a 'systemic, highly organised and externally advised process.' [2]

Alarmingly, nationwide it is estimated that one in two hospitality workers are being illegally paid, within similar figures in the retail, beauty and fast food sectors.[3] Many businesses have been caught out deliberately doctoring payroll records and forcing vulnerable workers into wage pay-back schemes. Associated with the underpayment of wages is the underpayment of superannuation, which is affecting one third of eligible workers in Australia.

The Senate Committee also heard many reports of large companies engaging workers through labour hire agencies in a bid to avoid paying redundancy payments when they no longer require workers and to minimise workers compensation insurance premiums.[4] The negative impact on safety standards and the reduction in corporate responsibility for injuries and deaths at work due to the use of labour hire is particularly concerning. The Senate Committee reported the egregious example of the October 2016 death at a Perth construction site of a young German backpacker, recruited through a labour hire firm, whose death on site did not prompt the host company to pause work on site or even contact the police promptly.[5] The move in various Australian States to combat such occurrences through labour hire licensing schemes is commendable, but more will need to be done.

1 Senate Standing Committee on Education and Employment, 'Corporate Avoidance of the *Fair Work Act 2009*' (September 2017).
2 Ibid.
3 Ibid.
4 Ibid.
5 Ibid.

Aside from safety concerns, the use of labour hire is having a detrimental effect on wages and conditions for workers, with labour hire often deployed strategically to undercut unionised workforces. The CUB 55 dispute in 2016 threw this phenomenon into the national spotlight. There, 55 Carlton & United Brewery maintenance workers in Victoria were told they could reapply for their jobs, but through CUB's new labour hire agency. That labour hire agency had years earlier used three casual employees, unconnected with CUB, to vote up a non-union enterprise agreement. That agreement was offered to the 55 CUB workers, and it was one that would have reduced their wages by 65%.[6] A strong union campaign prevented the company from succeeding with that strategy, but there was nothing illegal about the company's behaviour under our current laws.

Tax Minimisation and Tax Avoidance

Research has revealed that 36% of big firms and multinationals pay zero tax in this country.[7] The biggest multinationals that do pay tax on average pay half the 30% corporate rate, less than a working nurse.[8] Tax avoidance techniques stripped over $5 billion from taxpayers in 2013 and 2014. This is at the same time as company profits are soaring. For instance, ExxonMobil made over $25 billion over the last three years without paying one cent of corporate income tax.[9]

Environmental Pollution

Severe environmental harm is often the cost of big business' unfettered pursuit of bigger profit margins. For instance, oil production company PTTEP was responsible for one of Australia's worst oil spills in 2009 off the Western Australian coast when oil leaked from its rig for 11 weeks. PTTEP admitted that it failed to take all reasonable steps to prevent the spill from occurring and placed workers in danger on the rig. Despite this, and despite polluting the ocean with millions of litres of oil, the company was fined just over $500,000 - far less even than the paltry maximum penalty under the relevant environmental legislation of $1.5million.[10] The company continued to win exploration licences after the disaster.

Phoenixing

There is a widespread phenomenon of company directors avoiding debts to the tax office and other creditors by stripping assets and cash from their companies and hiding those assets, liquidating the company and starting again under a new guise, often repeating that cycle many times over. This company phoenixing activity costs the Australian economy billions of dollars each year. [11]

6. Ibid.
7. https://www.theguardian.com/australia-news/2017/dec/07/australian-tax-office-says-36-of-big-firms-and-multinationals-paid-no-tax
8. https://www.smh.com.au/national/how-76-profitable-companies-left-australian-taxpayers-56-billion-out-of-pocket-20160419-goa6o2.html
9. http://www.news.com.au/finance/money/tax/the-poster-boy-for-corporate-tax-dodging-exxonmobil-has-paid-no-tax-for-three-years/news-story/768e0c028737603557d522203c4bb173
10. http://www.abc.net.au/pm/content/2012/s3580571.htm
11. http://www.abc.net.au/news/2017-02-24/phoenixing-companies-too-easy-in-australia/8301638

Anti-consumer behaviour and financial mismanagement

The recent Banking Royal Commission has produced shocking revelations about unconscionable conduct engaged in by financial institutions in Australia. Among the many revelations are those concerning wealth management firm AMP, which was revealed to have to consistently misled the Australian Securities and Investments Commission and charged clients hundreds of millions of dollars in fees where no services were provided.[12] Outside of the Royal Commission, the Commonwealth Bank has agreed to pay the highest civil penalty in Australian corporate penalty –$700 million – after it admitted to more than 53,000 breaches of money-laundering laws that allowed drug syndicates to funnel millions of dollars offshore.[13]

Although labour laws, tax laws, environmental laws and so on all regulate corporate behaviour, the prolific and flagrant abuse of these various laws points to a more systemic problem.

12. See as an example https://www.theguardian.com/australia-news/2018/apr/27/amp-could-face-criminal-charges-for-misleading-asic-banking-inquiry-hears
13. https://www.bloomberg.com/news/articles/2018-06-03/commonwealth-bank-to-pay-a-700-million-to-settle-laundering-suit

Corporate Misconduct - Why Is This Happening?

Corporations engage in misconduct because they operate within a system where the balance is heavily favoured towards their interests. They are allowed to misbehave, and they often get away with it. But it was never meant to be this way.

With corporate privileges come responsibilities

Businesses incorporate to take advantage of privileges, including separate legal personality, limited liability and corporate tax rates. These privileges enable corporations to raise large amounts of capital to fund investment and operations.

The earliest kinds of associations known as companies in England were those engaged in monopoly foreign trade – the Russia Company, the Turkey Company, the East India Company. In order to be recognised as independent companies, individuals needed to petition for the grant of a royal charter or an Act of Parliament. Once granted, these companies could sue and be sued, and existed in perpetuity. Over time, they were recognised as shielding their members from liability for all company debts.

In the early nineteenth century, a new system for incorporation of companies by registration rather than through charter was established, with limited liability extended to these registered companies in 1855. An incorporation-by-registration system is the one we have in place today in Australia.

The economic imperative for the policy change was the increasing scale and complexity of production processes and markets at that time. Leading sectors of the economy such as the British railway construction required new organisational forms to raise the necessary vast sums of capital and coordinate complex production on a mass scale. **The company form facilitated these large-scale development projects that were in the public interest.**

The very existence of the corporation, and the attendant privileges of separate legal personality and limited liability, clearly were never and are still not divine rights, they are rights bestowed by governments and society - whether by royal charter or by registration approved by government. And as Professor Stephen Bottomley, Head of ANU's Law School has noted -

> *"Specific Parliamentary grants of incorporation were usually* ***conditional on the demonstration that some public purpose would be served by the enterprise."*** [14]

There was an explicit social licence to operate, defined as "a concept whereby a company's stakeholders grant the company an unwritten authority to do business."[15]

14. Stephen Bottomley, 1990, 'Taking Corporations Seriously: Some considerations for corporate regulation', Federal Law Review, Volume 19, pp. 203-222.
15. https://static.treasury.gov.au/uploads/sites/1/2017/06/04_CSR.pdf

Over time, and with the advent of general incorporation legislation, this link has become more implicit – but it has never gone away. Indeed, recent surveys have found that nearly nine in ten citizens across 23 countries support governments taking active legislative and regulatory steps to ensure social and environmental responsibility by companies, rather than leaving it to business to take steps voluntarily.[16]

The problem is there is very little in the way of corporate legislation or regulation to enforce these responsibilities.

Legal regulation - Directors' Duties

Under existing Australian company law, directors owe a duty to 'exercise their powers and discharge their duties in good faith in the best interests of the corporation.'[17] Although these duties are owed to the company and not directly to the shareholders, courts have generally interpreted the 'best interests of the corporation' to give primacy to shareholders' commercial interests.

This was recently reiterated in a submission by prominent corporate law firm, King & Wood Mallesons, which argued that -

> ***"[The notion that] directors should have regard to the interests of other stakeholders in a similar manner as they currently do to shareholders...is inconsistent with Australian law, which adheres to the shareholder primacy view of directors' duties, which holds that directors of solvent companies must focus on the company's interests – being the interests of the company's shareholders as a whole – and disregard extraneous interests in favour of the shareholders' interests where the two conflict."*** [18]

The CEO of the Commonwealth Bank of Australia Matthew Comyn has even revealed shareholders have told him: "your only job is to maximise the value of the firm.

The general rule as to taking non-shareholder interests into account, is that it is only permitted in so far as it is in the interests of shareholders to do so. Directors do not at law owe a more general, public legal duty to act in pursuit of the best interests of other stakeholders like the employees or the community more broadly.

Although corporations must abide by applicable laws that do protect other stakeholders to a certain extent – such as labour laws and environmental laws – it is not the core business of business. And given the problems discussed above, reliance on distinct subject-area, outer-limit regulation is clearly not working.

There are clear circumstances where other stakeholder interests should take priority over immediate profit maximisation. One such example was the decision of James Hardie Group to restructure its corporate affairs to quarantine itself from liability arising from the health effect of its asbestos products. The decision was clearly in the financial interests of shareholders (and completely legal) but was also

16. https://globescan.com/large-global-majority-favours-further-regulation-to-compel-corporate-good-behaviour/
17. Section 181(1) of the Corporations Act 2001 (Cth).
18. https://www.asx.com.au/documents/regulation/king-wood-mallesons.pdf

clearly contrary to the interests of employees and others suffering from asbestos-related diseases from contact with James Hardie products.

Personal liability of directors

Not only do directors not owe a positive legal duty under the Corporations Act to act in the public interest, but it is also difficult to hold them accountable when the company contravenes existing laws that protect that interest.

Although the corporation cannot think and act for itself, as a separate legal entity it is shrouded in a 'corporate veil' that, for the most part, shields shareholders and directors from being held liable for the actions of the company.

Directors overseeing the corporation's activities are usually not personally liable for breaches of the law such as wage theft, the tax avoidance, and the environmental and other harm that corporations cause. There are exceptions under the various pieces of legislation where directors have individual liability for the corporation's activities, for example there are relevant provisions under corporations, industrial, taxation, trade practices, environmental protection, and occupational health and safety laws. However, the relevant tests set a high bar, for instance requiring that the director have "aided, abetted, counselled or procured" a contravention,[19] or have been "knowingly concerned" in the contravention[20] - these evidentiary standards are especially hard to prove in the case of large-scale corporations or franchise models operating across multiple layers of management.

Mandatory Reporting

Given the absence of a clear positive duty on directors to act in the interests of non-shareholder stakeholders, it is not surprising that corporations are currently not under extensive obligations to report how their activities impacted those stakeholders. Section 299(1)(f) of the *Corporations Act* provides an obligation for a directors' report to include details on the entity's performance in relation to any "particular and significant" environmental regulation under a law of the Commonwealth or a State or Territory. This provision has been justifiably criticised for being vague. Under s 295 the Act, company financial statements must give a "true and fair view" of the "financial position and performance of the company." This is too narrow to give an accurate indication on the company's impact on the community and non-shareholder stakeholders.

Corporations are taking advantage of the privileges afforded to them. Rather than recognising these privileges come with a responsibility to serve the public interest, corporations are using them to maximise profit and perceived shareholder value at the expense of other interests

19. See eg Trade Practices Act 1974 (Cth) at s 76.
20. See eg *Fair Work Act 2009* (Cth) at s 550(2).

The consequences of the current law

While there are many examples of corporations supporting worthwhile projects that benefit the community and environment, there is very little evidence of how the public good, not just profit, is at the core of their business model. Shareholders may vote to place some sort of corporate social responsibility charter into the company's constitution (which directors are bound by) that requires directors to consider non-shareholder interests in their decision-making. Such a model of self-regulation, however, leaves corporate social responsibility at the whim of each individual company.

There is very little external input and regulation

Earlier this year, the ASX Corporate Governance Council proposed introducing the concept of a social licence to operate into the ASX'S Corporate Governance Principles. The principles are a set of recommendations that act as a benchmark for corporate governance practices, including how to respond to stakeholder expectations. However, there is no obligation for a company to adopt the recommendations. A board simply needs to explain why it has adopted alternative practices.

The Council's proposal involved amending existing Principle 3 from a "listed entity should act ethically and responsibly" to a "listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner".[21] The proposal also stated that, "preserving an entity's social licence to operate requires the board and management of a listed entity to have regard to the views and interests of a broader range of stakeholders... including employees, customers, suppliers, creditors, regulators, consumers, taxpayers and the local communities in which it operates."[22] This included "paying a living wage to employees", "not engaging in aggressive tax minimisation strategies" and "acting responsibly towards the environment."[23]

Despite the seemingly self-evident nature of the proposal, it faced fierce opposition from a number of company directors, corporate law firms, as well as the Australian Institute of Company Directors. Their arguments included criticism that the principle was too subjective[24] and would amount to a "corporate nanny state."[25] Conservative commentator Janet Albrechtsen even claimed the proposal would allow "social engineers to storm the boardrooms with pet agendas."[26]

21. https://www.asx.com.au/documents/asx-compliance/consultation-draft-cgc-4th-edition.pdf
22. Ibid.
23. Ibid.
24. https://www.theaustralian.com.au/business/companies/social-licence-draws-backlash-from-investors/news-story/e2f2091935f0f39602be513922abfe78
25. https://www.theguardian.com/australia-news/2018/aug/10/corporate-australia-is-locked-in-a-culture-war-but-its-not-about-left-and-right
26. https://www.theaustralian.com.au/opinion/social-activists-have-left-a-trojan-horse-at-the-asx-gate/news-story/a573c1f0d7b692f76b068832837d8a34

The Chair of the Corporate Governance Council, Elizabeth Johnstone, has signalled the final version of the principles – due to be released in early 2019 - will not include the requirement for companies to hold a social licence to operate.[27]

The extent and highly emotive nature of this opposition clearly demonstrates that Australian corporations are very protective of their perceived legal right to maximise shareholder value, even when this comes at the expense of acting in an ethical and socially responsible manner.

Two things are clear. The current model of corporate social responsibility is soft-touch, with no teeth. Second, it's clear that we cannot rely on business to self-regulate.

The growing dangers of not acting

As business encroaches further and further into the provision of basic public services, the danger of there being no real mechanism to compel companies to act in the public interest is becoming more acute.

Historically, governments have provided services such as healthcare, aged care, education and transport to address a market failure, and/or because the service was seen as so important that it should not be provided for profit. Government-provision was often complemented by not-for-profit providers.

However, successive waves of privatisation and marketisation of government services mean corporations can now profit from the delivery of these services. Large corporations now own and control refugee and migrant settlement services, vocational education services, motorways and railways, hospitals, aged care services and early childhood education centres.

The RTBU believes these services should not be privately-run. **Government-run services are accountable to the public; privately-run services are ultimately accountable to shareholders.** But as a last resort, in the event that privatisation cannot be reversed, the fact that the directors of these companies have no legal duty under the Corporations Act to consider the impact of their business on wider stakeholders is a serious concern. Maximising profits for shareholders can come at the expense of service quality, safety and staffing levels.

For example, Victorian taxpayers are currently losing out on approximately $65 million a year – money which is being taken out of the public transport system as profits by multinational transport operators. These profits are not the dividends of better or more efficient services, but rather are based on government subsidies and cost-cutting initiatives and shortcuts that undermine the quality of public transport services – trains that skip stations, trams that do not reach destinations and increasing maintenance backlogs.

27. https://www.afr.com/leadership/governance-council-backs-down-on-industry-supers-social-licence-push-20180806-h13lc7

Concerns are currently being raised about cost-cutting measures at a new privately-run hospital on Sydney's northern beaches. Staff and patients are justifiably concerned that the hospital's owner, ASX-listed Healthscope, is putting profits before patients. Since the hospital opened, there have been repeated examples of understaffing, a lack of vital medical supplies and insufficient mid-wife led birth services. At the same time, a takeover bid on the sharemarket is also underway against the company, which begs the question: to whom are Healthscope's directors and management accountable – shareholders or patients?

The inherent tension between shareholder and community interests is demonstrated by the fact that almost $500 million was wiped off the share prices of Australia's four largest aged care operators after the Federal Government announced a royal commission into the sector. Investors anticipate the commission will recommend new regulations around staffing, training, safety and other measures that may affect profitability. The more regulations there are to protect the public, the lower the perceived value for shareholders.

These attitudes mean it is much harder to create a culture in which the quality of the service is just as important as making a profit.

Impact on organisational culture

The framing of the corporation's core objective as shareholder wealth and profit maximisation has a significant influence over organisational culture and behaviour across all levels of the company, which ultimately hurts the community.

As the interim report of the Financial Services Royal Commission noted –

> ***"Much if not all of the conduct identified in the first round of hearings can be traced to entities preferring pursuit of profit to pursuit of any other purpose.... Staff and others engaged by an entity will treat as important what they believe that the entity values. Rewarding volume and amount of sales is the clearest signal that selling is what the entity values. What staff and others believe that the entity values informs what they do. It is a critical element in forming the culture of the entity.... Employees of banks learned to treat sales, or revenue and profit, as the measure of their success."***[30]

The Royal Commission repeatedly exposed the way in which remuneration structures, designed to maximise company sales (and profits), directly shaped a culture of unethical and unlawful behaviour that adversely impacted customers and communities. This included examples of aggressive cross-selling of financial products and services, overcharging of interest and fees, charging fees for no service, inappropriate advice, irresponsible lending conduct and fraudulent behaviour.

28. https://www.smh.com.au/national/nsw/mothers-fear-new-northern-beaches-hospital-puts-profits-before-babies-20181107-p50ehd.html
29. https://bmjopen.bmj.com/content/4/5/e004551.full
30. https://financialservices.royalcommission.gov.au/Documents/interim-report/interim-report-volume-1.pdf

Prioritising profit and shareholder value above other interests also compromises the safety of workers and the wider public. For example, freight rail operators are constantly pushing for weakened safety controls, such as shift lengths, rest breaks and qualification levels, in order to reduce labour costs and increase profit. What is most disturbing about these proposals is that they seek to undo controls that were implemented following inquiries that took place following fatal rail accidents. This approach is dangerously short-sighted – rail operators may indeed save money, that is, until there is an accident.

Similar issues exist in the road transport industry. In July 2018, it was revealed a bus company operating in Sydney was offering a $5,000 bonus to the driver with the highest weekly "on time running score".[31] Road safety experts warned this scheme promoted risk-taking behaviour and speeding over driver and passenger safety.

Surveys of truck drivers also consistently reveal they experience pressure to drive over the speed limit to meet deadlines on at least some trips in order to meet performance pay targets. Performance-based pay systems may increase profits, but they also normalise a workplace culture in which drivers feel they have little choice but to risk their safety, and the safety of other road users, just to be paid a decent wage.

It is clear that something needs to change when corporate laws and regulations allow profit to be placed above the safety of workers and their communities.

Long-term financial pain for shareholders

The regulatory system's focus on profit maximisation also has demonstrable negative flow-on effects for companies, not just the community. It encourages conduct that may be beneficial to the short-term interests of the corporation, but detrimental to its long-term interests.

For instance, mining and energy companies are currently lamenting the lack of national policy on climate change. Most recently, the CEO of Woodside Petroleum, Peter Coleman, called for a price on carbon and criticised "the lack of a clear road-map from successive governments" on climate policy.[32] The lack of policy is obviously affecting Woodside's long-term planning and investment decisions, future profits and shareholder value.

However, Woodside must also take its share of the blame – in 2009 and 2011, the company vocally opposed the Rudd and Gillard Government's carbon price policies. If Woodside's shareholders are losing out due to the lack of climate change policy, they should blame the directors and executives who have previously put short-term profits over the company's long-term interests.

Similar issues exist in the financial services industry. The Royal Commission exposed conduct which was probably beneficial to company profits and shareholder value in the short-medium term. However, as these companies have subsequently announced their responses to the Royal Commission (including divestments), their share values have fallen, and profits are expected to be lower in the long-term.

31. https://www.dailytelegraph.com.au/news/nsw/5000-carrot-for-being-on-time-a-great-way-to-incentivise-workers-says-minister/news-story/a1c562f9f48584f9d9b9c5fc8f545516

32 https://www.smh.com.au/business/companies/risk-is-too-great-woodside-ceo-rails-against-climate-inaction-20181113-p50fo9.html

For instance, following AMP's announcement that it intended to divest its life insurance business, shares in the company fell almost 25 per cent.

It is clear that the existing legislative and regulatory framework based on the principles of shareholder primacy and profit maximisation is not only bad for the community, it is also bad for business in the long-term.

It is also increasingly clear that companies that prioritise ethically, socially and environmentally responsible conduct are outperforming those that do not. According to the Responsible Investment Association Australasia, "core responsible investment Australian share funds outperformed the average large-cap Australian share funds over three, five and 10-year time horizons."[33] "Core responsible investments" are those which systemically consider environmental, social, ethical and governance issues.

Therefore, a systemic approach to corporate social responsibility is not only good for workers, customers, the community and environment, it is good for business.

33. https://responsibleinvestment.org/wp-content/uploads/2018/08/FACTSHEET_RIAA_RI_Renchmark_AUS_2018v3.pdf

Previous reviews into corporate law and corporate social responsibility

This is not a new discussion. Two high-profile reports into corporate social responsibility were handed down in 2006: the Australian Government's Corporations and Markets Advisory Committee (CAMAC) report, titled *The Social Responsibility of Corporations*; and the Parliamentary Joint Committee (PJC) on Corporations and Financial Services' report, titled *Corporate Responsibility: Managing Risk and Creating Value*.

CAMAC reported that "although there may be no direct legal obligation on directors to take the interests of stakeholders other than shareholders into account, this does not preclude directors from choosing to do so."[34] The report argued that a well-managed company will "respond to the impact of its activities on the environmental and social context in which it operates" and that failure "to do so appropriately may jeopardise their commercial future."[35]

However, the report concluded that the model of self-regulation at the time was sufficiently broad to enable corporate decision makers to consider the environmental social impacts of their actions and decisions.[36]

The PJC report also recommended no legislative change to directors' duties. It also noted that corporations benefit when the interests of other stakeholders are considered in decision making.

The PJC favoured the concept of "enlightened self-interest", defined as –

> ***"Companies and their directors should [acting] in a socially and environmentally responsible manner at least because such conduct is likely to lead to the long-term growth of their enterprise."*** [37]

The Committee was of the view that good directors and managers invest in stakeholder engagement and corporate responsibility. It also argued that legislative constraints were not the reason why companies failed to consider stakeholder interests.

In the twelve years since the CAMAC and PJC reports were released, the need for reform has become only more obvious and immediate. Corporate misconduct and misbehaviour are on the rise, despite the hourly news cycle and social media, live streaming of shareholder meetings and other forms of legislative intervention by governments to regulate corporate behaviour.

34. Corporations and Markets Advisory Committee, The Social Responsibility of Corporations Report (2006).
35. Ibid.
36. Ibid.
37. https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2004-07/corporate_responsibility/report/c04

How can we fix it?

It is evident the current system is not working. Reliance on self-regulation and ad-hoc corporate social responsibility programs do not address the underlying structural causes of corporate misbehaviour. Nor do they address the issues of organisational culture that contribute to misconduct.

These are not intractable challenges. Indeed, an increasing number of industry superannuation funds are proving that it is good business to invest in companies that demonstrate ethically, socially and environmentally responsible behaviour.

Irrespective of how difficult these issues may or may not be to resolve, business models that rely on wage theft, phoenixing, sham contracting, exploitative supply chain models, environmental damage or tax minimisation/avoidance, are unsustainable, for society, and in the long-run, for the corporation itself.

It is unreasonable to expect corporations to solve all of society's problems – but it is also unreasonable for corporations to expect they can continue generating profits at the expense of the common good.

Consequently, the following legislative changes are needed:

Directors' duties

Section 181 of the Corporations Act 2001 should be amended to include corporation social responsibilities and explicit obligations for directors to consider the interests of stakeholders, as well as shareholders:

A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the best interests of the corporation; and
(b) for a proper purpose; and
(c) with regard (among other matters) to:

(i) the impact of the corporation on the environment, the protection of aquifers, viable agricultural land and endangered species and the production of non-biodegradable waste material;

(ii) the obligation to pay the full amount of corporate tax;

(iii) the interests of the corporation's employees;

(iv) the interests of the corporation's contractors and suppliers;

(v) the impact of the corporation's operations on the community in which it operates; and

(vi) the interests of the corporation's consumers.

Standing to enforce

Expanding directors' duties raises the issue of how aggrieved stakeholders can enforce the corporate social responsibilities obligations on directors.

To that end, the recommendations from the Australian Law Reform Commission's 1996 report, *Beyond the Doorkeeper: Standing to Sue for Public Remedies* are a valuable reflection point for policy makers. The Commission's recommendations, none

of which have been implemented, relate to specific proceedings relating to matters arising under the Constitution (or involving its interpretation) or federal legislation or are against the Commonwealth or a person acting on its behalf, and include:

- The adoption of a new, single and simple test for standing, to replace the wide range of existing tests;
- Removing the requirement for a person to have a "special interest" to commence proceedings;
- Enabling any person to be able to commence and maintain public law proceedings, unless the relevant legislation provides otherwise or the litigation would unreasonably interfere with the ability of a person having a private interest in the matter to deal with it as he or she wishes; and
- Enacting a Commonwealth standing statute to implement the Commission's recommendations.

Importantly, the Commission clearly stated that these changes will not lead to an increase in vexatious or frivolous claims and litigants. Courts have a number of mechanisms to manage the litigation process and to strike out matters for showing no cause of action or for being an abuse of process.

Directors who fulfil their duties to a corporation's shareholders and stakeholders have nothing to fear from reforms to the law of standing.

Ultimately, any changes to the laws of standing and intervention must be developed as part of the package of reforms for improving the accessibility and effectiveness of the legal system.

Personal liability of directors

In order to give real teeth to corporate social responsibility, the threshold for holding directors to account for breaches of the law should be lowered. Current tests for holding directors personally to account are too high.
The Corporations Act should be amended to establish a positive obligation for directors and other officers to make reasonable enquiries about and to prevent reckless, intentionally dishonest and illegal behaviour. If serious misconduct, such as systemic wage theft or environmental pollution is taking place, the test for directors should be straightforward - either they knew about it and are therefore responsible, or they didn't know about it and therefore failed in their duties.

Purpose of corporations and the Objects of Corporations Law

The Corporations Act should have an overarching Objects clause that clearly states the purpose of the Act is to ensure that corporate activity carried out in Australia is in the public interest. Company constitutions should be mandated to include a clause restricting companies from engaging in behaviour that would seriously harm the public interest, taking into account the effect of its behaviour on employees, the environment, taxation obligations and so on.

Public Interest Tests and Mandatory Public Reporting

The bigger the company, the bigger the impacts its activities have on the wider community. Once a company is large enough to have a serious impact

38. https://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/3650863/upload_binary/3650863.pdf;fileType=application/pdf
39. Ibid.
40. Ibid.

on the community, its continued existence, with all the privileges that incorporation entails, should be conditional on that company's performance on a public interest scorecard.

Therefore, the Act should be amended to implement a public interest independent audit process for companies over a certain value. The audit would assess the company's performance across a range of benchmarks, including:

- Conditions for workers, including along the supply chain, gender pay gay, breaches of industrial instruments;
- Environmental impact; and
- Compliance with taxation obligations.

These audits should be conducted in the same manner as financial audits and made publicly available. Restrictions and penalties should be placed on the continued registration of repeat offender companies.

Role of ASIC

The Australian Securities and Investment Commission Act 2001 should be amended to ensure it has the powers to enforce corporate social responsibilities and respond to breaches.

Australian Corporate Governance Authority

A new Australian Corporate Governance Authority (ACGA) should be established. A key part of ACGA's mandate will be to help ensure the changes in law translate to real, tangible and cultural change in Australia's corporate boardrooms. ACGA will also have an important research-based and corporate education function. This includes advising Governments about other changes, and support corporations to fulfil their social responsibility obligations.

The Authority's functions are, on its own initiative or when requested by the relevant Minister, to advise about any matter connected with:

(a) a proposal to make legislation or to amend legislation relevant to corporations;

(b) the operation or administration of legislation relevant to corporations;

(c) law reform in relation to legislation relevant to corporations;

(d) corporate governance; and

(e) corporate social responsibilities.

These are not a radical proposals. After all, corporations and their attendant privileges were designed to further the public interest, not to maximise private profits. All we are proposing is a return to the original objective of corporations.

These recommendations – combined with legislative changes to restore balance and fairness to industrial relations laws, end illegal phoenixing, improve environmental protections and crack down on corporate tax avoidance – will help address, on a systemic level, the harmful impact large corporations can have on the community when they neglect their social licence to operate.

RTBU

Rail, Tram & Bus Union (National Office)
Office: Level 2, Trades Hall,
4-10 Goulburn Street, Sydney NSW 2000
Phone: 02 8203 6099 **Fax:** 02 9319 2096
www.rtbu.org.au