Duty Towards Environmental Protection: Companies' Role Under the Companies Act No 07 Of 2007.

Y.P. Wijerathna[1] ,A. A. Edirisinghe[2]
[1]Lecturer, General Sir John Kotelawlaa Defence University, Kandawala Estate, Kandawala Road, Ratmalana, yasoda9010@gmail.com
[2]Lecturer, General Sir John Kotelawlaa Defence University, Kandawala Estate, Kandawala Road, Ratmalana ,aaedirisinghe@gmail.com

ABSTRACT

The Brundtland Commission's report defined sustainable development as "development which meets the needs of current generations without compromising the ability of future generations to meet their own needs". In this context, it is problematic whether companies conduct their corporate activities in line with doctrine of sustainable development. The proposed study expects to find out whether the Companies Act No 07 of 2007 imposes any duty towards environmental protection on Sri Lankan Companies. The study will evaluate the scope and the extent of these duties (if there are any) and whether the statutory duties imposed are adequate to protect environment. Overall approach to this study is qualitative. Further, relevant statutory provisions are analysed using the critical analysis method and the comparative analysis method. Critical analysis method was employed to analyze the relevant statutory provisions and the comparative analysis method is employed to examine similarities and differences between the Companies Acts of Sri Lanka and the United Kingdom. Qualitative data for the research was gathered through primary sources and secondary sources. Primary sources include the relevant statutes i.e. Companies Act No. 7 of 2007 of Sri Lanka and the Companies Act of 2006 of the United Kingdom and case law and the secondary sources include books with critical analysis, journals, theses and electronic resources. The basic limitation of this method is that it does not satisfactorily focus on the actual implementation of the existing legal framework. It is submitted that Companies Act No 07 of 2007 does not expressly impose a duty on Sri Lankan companies towards environmental protection. Hence the existing statutory provisions are inadequate and the Companies Act should be amended to include express provisions to guarantee environmental protection.

Key Words: Companies Act, Environmental Protection, Sustainable Development

1.Introduction

"When all the trees have been cut down, when all the animals have been hunted, when all the waters are polluted, when all the air is unsafe to breathe, only then will you discover you cannot eat money"

- Chief Seattle

Until the latter part of the 20th Century, 'development' was looked at and measured only from an economic perspective. However with the economic oriented development resulting in many problems such as environmental pollution, environmental degradation, poverty, social injustice and marginalization, world realized that this conventional thinking should be set aside. Gradually, people aimed for a kind of development which is socially inclusive and environmentally sustainable. The concept that the environment and the development should be managed in a mutually beneficial way rather than as separate issues first gained international recognition majorly in 1972 at the UN Conference on the Human Environment held in Stockholm. A decade and half later, in 1987 the United Nations World Commission on Environment and Development in a report called Our Common Future (Brundtland Report) provided the most recognized definition to the sustainable development as "development which meets the needs of current generations without compromising the ability of future generations to meet their own needs".

Companies as business entities directly contribute to the national development. Traditionally, companies are established with the sole aim of providing profits for the shareholders on their investments and Company law aims to ensure accountability of managers to shareholders. However, with the emerging trend of promoting sustainable development it is clear that this traditional role of Company Law should be widened to ensure much more than making of profits for shareholders. Sustainable development represents corporate social responsibility on a corporate level.

1.1. United Kingdom

Unlike Sri Lankan Act, the Companies Act of 2006 of the United Kingdom (UKCA) has given consideration to environmental impact of the companies operation to some extent. The Act has expressly incorporated the duty to consider this impact on the directors.

S. 174 of the UKCA refer to directors' duty of good faith. S.174 of the Act specifies that directors should exercise good faith acting in a manner which according to his idea is most likely to promote the success of the company while specifying six factors to be given consideration when acting. The section states as follows;

"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 doing so 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.
(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".

This section expressly makes directors duty bound to consider and care for the environment when they take business decisions and guide the operations of the company. This can be seen as a progressive step taken towards assuming companies' role in the modern world to protect environment. In addition to this express obligation, the specification that directors while promoting the success of the company for the benefit of its members as a whole, should give regard to 'the likely consequences of any decision in the long term', suggests that companies should be sustainable in its existence. This requirement will make it an obligation for a company not to harm the environment and the community for the sake of its short term economic development goals.

Nevertheless, it is noteworthy that, in considering environmental matters, directors will have to articulate a business case, viz. that such considerations would promote the success of the company for the benefit of its members as a whole, whether in the short-term or long-term.

Further, the S. 415 of the UKCA requires directors to prepare a director's report for each financial year of the company and as specified by S.417 (1), unless the small companies' regime, the directors' report must contain a business review. As per, S. 417 (5) (b) (i), in the case of a quoted company, this business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include, inter alia, environmental matters (including the impact of the company's business on the environment). However, the S. S. 417 (6) states that when a company qualifies as medium-sized in relation to a financial year directors report does not have to include non- financial information such as environmental matters and employee matters.

1.2. Sri Lanka

S. 187 of the Sri Lankan act is similar to the S. 174 of the UKCA since it requires directors to act in good faith. However, unlike the s. 174 of the UKCA, Sri Lankan act does not make it a duty for the directors to care for the environment or aim for sustainable development and it merely states that '*A person exercising powers or performing duties as a director of a company shall act in good faith, and subject to subsection (2), in what that person believes to be in the interests of the company*.'

The duty of the director to act in the interest of the company can be interpreted to include environmental aspects. Traditionally this duty was given a conservative interpretation; director's duty is to raise profits for benefit of shareholders. However, now most of the jurisdictions have given a progressive interpretation to the duty of the director to act in the best interest of the company. For example, Supreme Court of Canada, in *Peoples Department Stores Inc. (Trustee of) v. Wise* (2004) held that "We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment". However, in Sri Lanka the directors' duty to act in good faith and in the interest of the company has not yet been expressly extended to include environmental concerns through a progressive judgement.

Further, the Companies Act in Sri Lanka does not contain provisions to disclose environmental impacts of companies through annual reporting. The Act imposes a duty on the companies to prepare financial statements (Section 150-153). According to section 150 (2) if the company failed to do so, every director of the company who is in default shall be guilty of an offence. Section 151 specifies the contents and form of financial statements. These sections, however, do not specifically mention that the environmental aspects shall be taken into account when making financial accounts of the company. They do not impose a duty or a requirement on the directors to take such factors into account with respect to annual reporting or as a general duty of the directors as well.

The Accounting standards introduced by the Charted Institute of Accountants in Sri Lanka under the provisions of Sri Lanka Accounting and Auditing Standards Act No.15 of 1995 impliedly facilitate for environmental reporting and disclosure to a certain extent (LKAS 1, LKAS 8, LKAS 16). However, the application of these standards is confined only to a certain set of companies specified in the schedule to the act referred to as 'Specified Business Enterprises'.

The Code of Best Practice on Corporate Governance which is a joint initiative between the Securities & Exchange Commission and the Institute of Chartered Accountants of Sri Lanka provides a considerably strong framework for environmental accountability. According to clause D.1.4. of the Code, annual reports of the Listed Companies should contain "Management Discussion & Analysis", discussing social and environmental protection activities carried out by the Company. Moreover, it provides for sustainability reporting and states that Environmental Governance of an organization should adopt an integrated approach that takes into consideration the direct and indirect economic, social, health and environmental implications of their decisions and activities, including pollution prevention, sustainable resource use, climate change, protection of environment, bio-diversity and restoration of national resources. The code insists that the products of the listed companies shall be environmentally friendly. However the Code of Best Practice on Corporate Governance is not a legislation and it shall be mandatorily complied with only by the listed companies. For non-listed companies there is no such mandatory requirement to comply with the code.

2.Moving Forward

It is evident by the above discussion that UKCA of 2006 is many steps ahead of the SLCA of 2007 in promoting responsibility of companies to protect environment. However, it should be stated that the laws enshrined in the UKCA are not adequate in the current context to achieve the aim of sustainable development to a satisfactory level.

Following the example given by English Company Law, Sri Lankan Act can impose an obligation on the directors to consider environmental impact of business operations and also the long term impact of the business decisions when they act in good faith in the interest of the company. However, the issue to be analysed in this context is whether law should permit directors to take environmental concerns in to account even when they do not relate to the promotion of success of interest of the company, or in other words when such considerations gives no benefit to the company by increasing shareholder returns. In fact it can be argued that directors should be able to consider environmental sustainability side by side with interest of the company (Johnston, 2014).

With regard to companies' responsibility towards protecting the environment, the concept of Corporate Social Responsibility (CSR) plays a significant role. CSR can be defined as the responsibility of enterprises for their impacts on society. This concept is widely known as the "corporate citizenship" and it is an aspect of the corporate sustainability phenomenon (Marrewijk , 2003). CSR can demand bearing of short term expenses which will not result in instantaneous financial gains to the business, but rather will encourage positive transformation in societal and environmental aspects. According to CSR, the companies while advancing the profits of its shareholders are obliged be accountable to the society and the environment and act ethically. In the decision making process, companies should consider the societal, economic and environmental impacts of such decisions. Actions taken by the corporate citizens related to the preservation of the environment could be said to operate as the most important and common function associated with the CSR concept.

According to Silberhorn and Warren (2007) the concept of CSR progressed as a reaction to the interactions between organizational values and external influences. While some businesses voluntarily practice corporate philanthropy and chose to contribute to the social and environmental demands, the other business enterprises are forced to comply with the concept of CSR, as a result of social, governmental, political, and judicial pressure (Lambooy, 2014). In present, laws have been enacted to encourage the social responsibility of companies. For instance, S. 135 of the Indian Companies Act of 2013 specifies that all companies having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall establish a CSR Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director, while providing guidelines for companies to follow when they proceed with the CSR activities. FMorover, the S. 135 imposes an reporting obligation on the board of the company. Accordingly, the board is required to approve the CSR policy for the company after taking into account the recommendations made by the CSR committee and disclose its contents in their report and also publish the details on the company's official website, if any, in such manner as may be prescribed. If the company fails to spend the prescribed amount, the board, in its report, shall specify the reasons. Further, the Act encourages companies to dedicate at least 2% of their average net profit in the previous three years on CSR activities. Among objectives such as protection of human rights and labour rights, sustainable development and protection of environment are two major objectives these kind laws intend to achieve.

Further, the most justifiable approach towards sustainability is binding the company to bear the costs of their activities without leaving the affected members of the public to bear such cost. This approach is promoted by the Polluter Pays principle in Environmental Law which states that whoever is responsible for damage to the environment should bear the costs associated with it. Polluter pays principle not only advances fairness and justice, but also enhances economic efficiency. In Sri Lankan context, Polluter Pays principle was upheld in the landmark judicial decision *Bulankulama vs Secretary, Ministry of Industrial Development* (2000). In this case Justice Amerasinghe stated in clear terms that the cost of environmental damage should be borne by the party that causes such harm, rather than being allowed to fall on the general community to be paid through reduced environmental quality or increased taxation in order to mitigate the environmentally degrading effects of a project.

In economics, an externality refers to a result of a business operation that affects unrelated third parties. As stated by Buchanan & Stubblebine (1962), an externality connotes the cost or benefit that affects a party who did not choose to incur that cost or benefit. These externalities can either be positive or negative. While research and development conducted by a company is an example to a positive externality, air pollution, noise pollution or water pollution that results from the industrial activities provides an example to a negative externality. Negative externalities are also known as externals cost or external diseconomy. If companies merely focus on generating profits while neglecting negative externalities, it will lead to inefficient markets. Therefore, it is important for governments to intervene to curb these externalities and Company Law to make regulations to internalize the externalities so that negative externalities such as environmental pollution will affect not only the third parties but mainly the parties who choose to incur such costs and benefits. As Justice Amerasinghe held in Bulankulama Case (2000) today environmental protection, in the light of the generally recognised Polluter Pays principle, can no longer be permitted to be externalized by economists merely because they find it too insignificant or too difficult to include it as a cost associated with human activity.

3.Conclusion

The idea that companies should be required by law to take responsibility for environmental costs and be committed for environmental protection goes against the conventions perception of the role of the Company Law. The Anglo American view that company law should focus only on the agency relationship between the directors and shareholders (and creditors) narrows the role of the Company Law. However, the modern Company Law should not remain restricted by this traditional perception and rather it should promote sustainable companies which assume responsibility for environmental protection alongside their profit generation goals.

Sri Lankan judiciary playing an active role, in some instances has given effect to the Polluter Pays principle in cases relating to environmental pollution and thereby has attempted to bind the companies to some extent. However, the Polluter Pays principle addresses only post-pollution situations and it provides the remedy only after the damage has been done. However, 'prevention is better than cure' and specifically in case of environment cures can be difficult, expensive and sometimes just too late since in most cases the damage is irreparable. Therefore, it is always prudent to prevent the environmental damage than to fix it after it has been done. Companies should be obliged to follow a precautionary approach and comply with concepts such as CSR.

However, as evident by the above discussion, Company Law in Sri Lanka is steps behind many other jurisdictions, in its commitment to protect environment. Sri Lankan Companies Act does not enclose the progressive concepts such as CSR. In the modern context where environmental degradation and ecological imbalances have become one of the major problems or the most important problem that should be addressed by developed as well as developing countries, it is high time for Sri Lankan Companies Act to embrace this new concept and push the corporate community to perform their roles as responsible corporate citizens towards the environment and the society in the eyes of their customers. Further, Sri Lanka should take legislative steps to introduce requirements such as submission of a business review in to Company Law, with the legal obligation to report non-financial disclosures including environmental impacts of company's operations and such steps will establish the corporate responsibility to protect the environment for the sake of present and future generations.

References

Buchanan, W., & Stubblebine, C., (1962). Externality. Economica, 29 (116). http://www.jstor.org/stable/2551386

Bulankulama vs Secretary, Ministry of Industrial Development 3 SLR 242 (2000).

Lambooy, T. (2014). Legal Aspects of Corporate Social Responsibility. *Utrecht Journal of International and European Law*, 30(78).

Marrewijk , M.V. (2003). Concepts and Definitions of CSR and Corporate Sustainability: Between Agency and Communion. *Journal of Business Ethics*, 44.

Oxford University Press (1987). *Our Common Future* (Brundtland Report). Oxford: United Nations World Commission on Environment and Development.

Peoples Department Stores Inc. (Trustee of) v. Wise SCC 68 (2) (2004).

Professor Andrew Johnston University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2014-05) *Reforming English Company Law to Promote Sustainable Companies* http://ssrn.com/abstract=2428700 accessed 14 September 2016

Silberhorn, D & Warren, R.C. (2007). Defining corporate social responsibility: A view from big companies in Germany and the UK. *European Business Review*, 19, 252-372.