

ETHICAL CONVERSATIONS – A CHALLENGE FOR BOARDS?

Keynote address to a forum for public sector board members, hosted by the Integrity Commission of Tasmania

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by

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It's probably appropriate that I begin my remarks today with a confession. When the Integrity Commission first approached me about presenting a keynote address at this conference, my initial reaction was not, as they were probably hoping, "oh, yes, absolutely, where and when?" It was more along the lines of "Why me? I have no particular expertise in matters of ethics" and – although I didn't say so explicitly – "why don't you ask Simon Longstaff [of the St James Ethics Centre, who does have that sort of standing]?".

But Michael Easton was nothing if not persistent, and in the end it didn't really take all that long for me to recognize that ethical issues arise in almost every area of professional life; that I've had to grapple personally with ethical challenges from time to time; and that having been on one of Tasmania's more visible and significant public sector boards for nearly nine years, there probably were some things I could usefully say on an occasion like this.

So, here I am. I should say at the outset that, although a good deal of what I intend to say today is informed by my experience on the board of Hydro Tasmania, and I will illustrate a couple of the points I want to make by reference to that experience, I am not speaking here today on behalf of Hydro Tasmania – or any other entity with which I have an association – and the opinions I am going to share with you are entirely my own.

Since this forum is intended for current and aspiring members of public sector boards, it's worth emphasizing first up that the duties, obligations and responsibilities of directors of government-owned businesses are, in most respects, the same as those which the Corporations Law and the common law impose on the directors of private sector companies. In the case of Hydro Tasmania, as a Government Business Enterprise, these duties, obligations and responsibilities – and the consequences of failing to discharge them – are spelled out explicitly in Part 5 of the *Government Business Enterprises Act 1995*; for some other entities such as Metro Tasmania or TT-Line, which are formally classified as State Owned Companies and incorporated under the Corporations Act, director's duties are explicitly as laid down in that Act.

Most of these legally-imposed duties and obligations are, in effect, statements about how directors are expected to 'behave' – for example, by exercising 'due diligence' and 'independent judgement', not misusing one's position as a director (or the information which one obtains as a director) in order to obtain a personal financial advantage, and avoiding actual or potential conflicts between one's obligations to the company and personal or other interests.

'Ethics' is about more than mere compliance with these and other obligations imposed by the law. It is about 'right and wrong'. It is about what we *ought* to do, or ought *not* to do, as distinct from what we are *allowed* by law to do, or *prohibited* by law from doing.

If 'character is what you do when no-one else is looking', then 'ethics' is how you go about deciding what you will do in those circumstances, when you think no-one else is looking.

And that's particularly important in the context of public sector organizations – because, in the end, it's much more likely that people *will* eventually look at what you've done, and why you've done it, in public sector organizations than elsewhere.

That's partly because more people perceive that they have a stake in the way public sector organizations conduct themselves – as the ultimate owners of those organizations, and in many cases as consumers of the products or services which those organizations provide (given that many government business enterprises are monopolies) – than they do in the conduct of private sector organizations.

And it's partly because, given the power which governments have over the way other people behave, there is a legitimate expectation that public sector organizations exhibit, and be held to, higher standards of behaviour.

In other words, while the *legal* or *financial* consequences of ethical failures in public and private sector organizations are likely to be similar, the *reputational* consequences of ethical failures in public sector organizations are likely to be greater than those of similar failures in private sector organizations.

What actually constitutes ethical principles and behaviour is more complex for an organization than it is for an individual – not least because ethical principles are usually derived from individual personal judgements or beliefs about what is right and wrong, and individuals inevitably differ in their beliefs about what is right and wrong, either in specific circumstances or in general.

Organizations therefore need to establish an ethical framework which individuals working in or for it can regard as consistent with their own individual ethical beliefs and principles. They need to ensure that this framework is actually used by individuals working in the organization to guide their everyday behaviour, actions and decisions. And they need to ensure that there are consequences for failing to behave, act or make decisions in accordance with this ethical framework.

This ethical framework, the various ways in which it is promulgated and instilled throughout the organization, and the ways in which departures from it are handled, are an integral part of the 'corporate culture' of any organization.

And the responsibility for establishing and maintaining the 'corporate culture' of any organization starts at the top – with the Board.

Most companies – and most government business enterprises – nowadays have some kind of formal Code of Ethics or Statement of Values which set out a number of ethical principles which are meant to guide the behaviour of all employees. However, that on its own is far from adequate. As the AICD notes in the materials used in its flagship Company Directors' Course,

“these codes provide a useful guide to matters that must be considered but they should not be taken as sufficient or comprehensive A code of ethics will only be useful if considerable effort and resources have been devoted to its ongoing implementation. Everyone in the organization needs to know about the code, understand what it means and how it impacts the way they behave in every aspect of their role ... The board must adopt, and in its own

behaviour and the behaviour of individual directors, display actions that support those values ...”

Hydro Tasmania has a [Code of Ethical Behaviour](#) which is periodically reviewed, and approved, by the Board. The latest version was approved in June 2013. It sits above the strategies, policies, standards, procedures and systems that guide the behaviour of everyone who works at Hydro Tasmania – including the directors. It consists of five broad principles, namely –

- We put people's health and safety first;
- We build value for our partners and customers through innovation and outstanding service;
- We behave with honesty and integrity;
- We work together, respect each other and value our diversity;
- We are committed to creating a sustainable future.

Each of these is 'fleshed out' by three or four more specific and meaningful statements. For example, under the heading 'work together, respect each other and value our diversity' – which on its own could be easily dismissed as a 'motherhood statement' - the Code says:

- We are proactive in raising concerns about issues we see in the behaviour of our colleagues, our partners, suppliers and customers;
- We avoid discrimination, bullying, or harassment in relation to anyone we deal with;
- We treat everyone with respect and in accordance with our equal opportunity guidelines;
- We strive to embrace change as part of our working environment.

These are, I think, clear statements of the behaviour expected of people working at Hydro Tasmania.

Likewise under the heading 'we are committed to creating a sustainable future' – a statement which on its own could quite justifiably be dismissed as bland and meaningless – the Code says, among other things:

- We consider potential environmental and social effects in projects and processes; and
- We are committed to working with others who demonstrate sustainability commitments.

The Code also provides practical guidance to employees as to how to work towards an ethical decision, including:

- Discuss the situation with others in your workplace to get other objective viewpoints;
- Consider what you would do if it were your money, time or equipment;
- Imagine changing places and being on the receiving end of your decision;
- Consider whether you could adequately defend your actions to your manager, or to someone in your family.

Finally, the Code explicitly sets out what people should do if they believe that someone is acting in a way that contravenes it, including the reporting mechanisms available under the *Public Interest Disclosures Act 2002* (aka 'whistleblowing').

Of course, such Codes, however well-expressed and however frequently promulgated, are only of value if they are 'living' documents – that is, if they are actively used in making decisions, big and small; if failure to uphold or adhere to the code has real consequences, calibrated to the seriousness of the breach; and if they are regularly reviewed to ensure that they remain relevant to the organization and its context.

Ultimately, ensuring that all of these requirements are met is a responsibility of the Board – which means that the Board needs to have conversations about them.

In my time on the Board of Hydro Tasmania, we have had such conversations from time to time – both about ethical behaviour in general, for example as when we have reviewed this Code, and on occasions when we have specifically applied ethical considerations in making particular decisions.

As a small but nonetheless I think meaningful example, every meeting of the Board of Hydro Tasmania, and of every Committee of the Board, begins with a 'safety moment', at which some aspect of the safety of Hydro's employees, contractors, or customers is noted and discussed. It may be a report of an adverse safety incident, or on other occasions an instance of someone pro-actively upholding Hydro's commitment to people's safety – but either way, it gives tangible meaning to the expression of intent contained in the Code.

Likewise, each Board meeting also has, as the second item on the agenda after apologies, a space for the disclosure of any interests directors may have, which may conflict with their obligations to Hydro Tasmania. Those disclosures are recorded, and a complete record of each director's disclosures appears in the papers for every Board meeting. In my time on the Board of Hydro Tasmania, directors have been meticulous about disclosing potential conflicts of interest, and in absenting themselves from boardroom discussions of matters in which they may have a conflict of interest. I'm also aware that, prior to my time on the Board, a director was removed for failing to disclose a conflict of interest.

On another occasion during my time on the Board, directors became aware that the behaviour of one of Hydro's executives was inconsistent, in multiple ways, with the requirements of Hydro Tasmania's Code of Ethics. For legal reasons I am not going to go into any great detail about the series of events involved, other than to say that once the Board was satisfied as to the facts of the matter, its ensuing decisions were very much guided by the ethical principles I outlined earlier, which resulted in the person concerned leaving Hydro Tasmania. We also subsequently asked ourselves whether there was anything we could have done to ensure that the departures from our values which were at the heart of this matter came to our attention earlier, or could have been prevented altogether – and again without going into detail we did draw some lessons from the conversations we had around that topic.

Another example, where I can go into more detail, arose during last year's energy supply challenge, produced by the combination of the driest six-month period on record and the extended outage of the Basslink cable. As you know, this resulted in Hydro Tasmania's water storages falling to very low levels, necessitating among other things the return to service of all the gas-fired generating units at the Tamar Valley Power Station, the installation and operation of 220MW of diesel generation at various locations around the state, and the negotiation of voluntary load reductions with major industrial electricity customers - at a cost most recently estimated to be around \$140 million.

One of the issues which the Board of Hydro Tasmania had to consider as this situation unfolded was that of how far the water level in yingina/Great Lake could be allowed to fall before putting at risk of extinction two species of [paragalaxias](#) – a genus of freshwater fish - which are endemic to yingina/Great Lake, and which spawn during spring and summer. Both of these species are on the Commonwealth Government's endangered species list.

Hydro Tasmania had previously, in 2005, established 'risk zones' below which it would not allow the water level in yingina/Great Lake to fall, based on, inter alia, scientific advice as to the levels at which the galaxiids' survival would be placed at serious risk. As the water levels in yingina/Great Lake approached these levels last summer, Hydro Tasmania convened a panel of external scientists to independently confirm the water level at which the ecosystem would face an escalation of risk. The scientific advice received was that the water level at which the risk to the galaxiids' survival would become extreme was higher than previously recognized.

This situation presented the Board of Hydro Tasmania with an ethical dilemma. On the one hand, running the water level in yingina/Great Lake down to the level previously regarded as 'acceptable' would risk the extinction of two unique species. On the other hand, constraining the use of water from yingina/Great Lake for electricity generation so as to avoid the water level falling to that level would entail either a greater risk of being unable to meet the state's electricity demand, or (more likely) entail higher costs associated with diesel generation.

The Board was advised that Hydro Tasmania was not *legally* obliged to give priority to the survival of the two galaxiid species over financial considerations (although that may well have been contested by others with a different view). And there were certainly some stakeholders who were strongly of the opinion that 'keeping the lights on' was of vastly greater importance than the survival or otherwise of some small and inedible fish.

However, the Board of Hydro Tasmania worked through these issues using the framework set out in its Code of Ethics. The Board explicitly required that the decision as to whether to enter the existing Extreme Environmental Risk Zone be assessed through the Corporation's Sustainability Code. Consistent with that, the paper which formed the basis for the Board's decision of this issue explicitly considered how each element of the Code applied to the situation. Having discussed the issue in the context of this ethical framework, the Board decided to raise the minimum level to which the water in yingina/Great Lake would be allowed to fall, in line with the scientific advice which it had received.

I am absolutely confident that this was the 'right' decision to have made. I'm also confident that it is one of which the overwhelming majority of the people of Tasmania would approve. And having a clear ethical framework undoubtedly helped us to arrive at the decision which we did.

One other area where directors of government business enterprises are more likely to face ethical challenges than their counterparts on private sector boards is in shareholder relationships. For directors of private sector entities, the law is clear: directors are obliged to act in the interests of the company, to exercise their own independent judgement as to what constitutes "the interests of the company", and not to favour particular shareholders or groups of shareholders over others.

For obvious reasons, the relationship between directors of a government business enterprise and the representatives of the government which is the sole shareholder in that enterprise is different, and so are the obligations of directors. The *Government Business Enterprises Act 1995* requires GBEs to "operate in accordance with sound commercial practice and as efficiently as possible", and to achieve "a sustainable rate of return that maximizes value for the State ... having regard to the economic and social objectives of the State". These requirements are also set out in the Ministerial Charter under which Hydro Tasmania operates.

Clearly, there is considerable potential for tension between the requirements to "operate in accordance with sound commercial practice" and "achieve a sustainable rate of return that maximizes value for the State" and the requirement to have regard to "the economic and social objectives of the State".

In my view – and I should emphasize that it is my *personal* view – it's not the role of individual directors of public enterprises, nor of the boards of public enterprises – to impose their own views as to what the "economic and social objectives of the State" are, or should be – although, in days now long gone by, Commissioners of the Hydro Electric Commission perhaps held a different view.

Rather – and again, this is my view – it's the role of the elected Government, acting on behalf of the people of Tasmania, to determine and stipulate what the "economic and social objectives of the State" are. Otherwise, there would be little point in the Government owning businesses.

However, I would go on to assert that when the elected Government wants a GBE to act in a specific way that is *not* "in accordance with sound commercial practice", or is inconsistent with achieving a "sustainable rate of return that maximizes value for the State", it should say so explicitly and transparently, rather than by way of opaquely transmitted 'nods and winks'.

There are a number of avenues through which an elected Government can properly make clear its view of what the "economic and social objectives of the State" are – including through the Ministerial Charter, Treasurer's instructions, the process by which GBEs' corporate plans are approved each year, and the provisions governing the declaration and performance of community service obligations.

An example of this during my time on the Hydro Tasmania Board arose with the transfer of the Tamar Valley Power Station and its associated assets and liabilities from Aurora Energy to Hydro Tasmania, ahead of the then proposed sale of Aurora Energy in 2013. This was not a transaction into which the Board of Hydro Tasmania, acting "in accordance with sound commercial practice" and seeking to "maximize value for the State" would have willingly entered. It was not a transaction into which, I believe, any ASX-listed company would have entered. However it was a transaction which was, in the opinion of the Government of the day, consistent with the "economic and social objectives of the State". The Government therefore gave a valid directive to the effect that this transaction should occur, and the Board of Hydro Tasmania complied with it, as it was obliged to do.

There was nothing improper, from a legal or ethical perspective, about any of this – and there was never any suggestion of which I am aware that any other process should have been followed. However, speaking once again in a purely personal capacity, I would not have been a willing party to this transaction in the absence of such a valid directive.

From a different perspective I can record my satisfaction that Hydro Tasmania did not receive any formal directives from Government regarding the decisions it made during last year's energy supply challenge – and nor am I aware of any decisions that were made as the result of other, more subtle, forms of persuasion, even though I am aware of some efforts to cajole the Government into exerting that kind of pressure.

So, my own experience is that having a clear and meaningful ethical framework, and actively referencing that framework in the course of making decisions, is an essential element of a sound governance in public sector organizations.

I want to conclude with one final observation about the mind-set that directors of government business enterprises should bring to their task.

Being on the board of a GBE is a form of public service. Although you do get paid, the pay is typically a lot less than what you would expect to get for devoting a similar amount of time and skill to being on the board of a similarly-sized corporation in the private sector. Contrary to what much of the media and some politicians seem to think, you don't get paid any 'bonuses'. Nor do you get to supplement your directors' fees, if the business does well, via increases in the value of your personal shareholding, or through the exercise of any options that you might be granted, as is often the case with directors of ASX-listed companies.

It may be that serving on a GBE board enhances your chances of being appointed to the board of an ASX-listed company, although that hasn't been my experience.

Against that, being on the board of a GBE is interesting and, rewarding in ways that aren't measured in dollar terms. Hydro Tasmania is a complex, but fascinating, business. It's managed and staffed by talented and motivated people, many of whom could get paid more than they do if they worked somewhere else. It is valued, and most of the time it is respected, by the people of Tasmania.

Being on its board for nearly nine years has been a privilege and an honour, as well as being a way of contributing something, however small, to the well-being of Tasmania and its people.

I would say, if you can't approach the task of being on the board of a GBE in something like that spirit, probably best not to take on the job.