CORPORATE SOCIAL RESPONSIBILITY

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I. INTRODUCTION

A. WHAT IS CORPORATE SOCIAL RESPONSIBILITY?

Whether corporations should be obliged to behave in a socially responsible fashion instead of just pursuing the most profitable course of action is an issue on which there has been heated argument in America since 1932.[1] The major

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1 Beginning with the classical debate between Berle and Dodd; see A Berle "Corporate Powers as Powers in Trust" (1931) 44 *Harv L Rev* 1049; EM Dodd "For Whom are Corporate Managers Trustees?" (1932) 45 *Harv L Rev* 1145. The forum for discussion in America has largely moved from the academic journals to the boardroom. Arguments about the pros and cons of CSR (*infra*) have infrequently surfaced in academic writings in England and the Australasian region with the same explicit focus; see CM Schmitthoff "Social Accountability" in *The Philosophy of Company Law Reform* (1982) p 79; The United Kingdom Department of Trade and Industry *Company Law Reform* Cmnd (1973) at [555]-[558]; M Fogarty *Company Responsibility and Participation - A New Agenda* (1975) chs 1, 11; LCB Gower et al, *Gower's Principles of Modern Company Law* (1979) p 62; R Landsdowne and J Segal "The Social Responsibility of Modern Corporations" (1978) 2 *UNSWLJ* 336; KW Wedderburn "The Social Responsibilities of Companies" (1985) 15 *MULR* 4; T Presbury "The Historical Development of the Corporation as an Organizational Unit" in KE Lindgren, HH Mason, BLJ Gordon (eds) *The Corporation and Australian Society* (1974) p 27; R Baxt "The Duties of Directors of Public Companies - The Realities of Commercial Life, The Contradictions of the Law, and the Need for Reform" (1976) *Bus L Rev* 289; P Redmond *Companies and Securities Law* (2nd ed, 1992) pp 80-98; The Senate Standing

problem with the debate on corporate social responsibility ("CSR") has been determining exactly what is meant by the concept and what is hoped to be achieved by its use.[2] There are four main ways of conceptualising CSR in this regard. The first two strands of the debate are aimed at enhancing corporate compliance with the present legal position. The latter two variants question whether corporations should be obliged to do more than they are currently legally required to do.

At present corporate management are legally obliged to act 'bona fide in the best interests of the company'. 'The company' in this context has conventionally been defined not as an abstract entity but as the members, both present and future, in their capacity as associated persons.[3] The first variant of the CSR debate reduces itself to the concern that corporate managers actually do enhance the company's, and hence the shareholders', financial interests rather than pursuing their own self-interest.[4] The second is aimed at ensuring that corporations abide by specific legal regulations[5] and involves the elaboration of

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Committee on Legal and Constitutional Affairs *Company Directors Duties Report on the Social and Fiduciary Duties and Obligations of Company Directors* (Nov 1989) at [6.25]-[6.56]; R Schaffer "Establishing the Elements of an Environmentally Aware Corporate Culture" (1992) *Environmental and Planning LJ* 44.

2 Because the debate has been defined in such broad terms it has ranged over many areas of substantive concern, been subject to analysis within political, legal, economic and sociological disciplines, examined from opposing ideological perspectives and often conducted at cross purposes. Dichotomies exist in the debate at almost every level of definition. The concept of a social duty has been viewed as based on either a legal obligation, as in E Weiss "Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse" (1981) 28 *UCLA L Rev* 343, or an internalised moral structure, as in C Stone "Corporate Social Responsibility; What it Might Mean Were it Really to Matter" (1986) 71 *Iowa L Rev* 557 at 559-60. The source of the duty has been seen as an expression of the collective will of society, as in D Engle "An Approach to Corporate Social Responsibility" (1979) 32 *Stan L Rev* 1 at 27-8, or as an informal assumption of responsibility, as in P Blumberg "The Politicisation of the Corporation" (1971) *The Business Lawyer* 1551. The characterisation of the decision-making process involved in CSR has alternatively meant the formulation of social policy, as in R Nader, M Green and J Seligman *Taming the Giant Corporation* (1976) and R Nader and M Green *Corporate Power in America* (1973), or the implementation of a "social consensus", as in D Engle above. The question of implementing CSR has inspired arguments calling for an alteration of the basic structure of the company or for tampering with market signals and the environment within which it operates. For a discussion of techniques which might be employed to do the latter see; R Reich "Corporate Accountability and Regulatory Reform" (1979) 2 *Hofstra L Rev* 5; RH Kraakman "Corporate Liability Strategies and the Costs of Legal Controls" (1984) 93 *Yale LJ* 857. Other writers have perceived the issue simply in terms of extending a mandate to be socially responsible to those in control of the company, as in R Baxt, *id.*

3 *Re Smith and Fawcett* [1942] Ch 304; *Greenhalgh v Arderne Cinemas Ltd* [1951] 1 Ch 286.

4 See, for example, discussions of management accountability, as in Fisher "The Corporate Governance Movement" (1984) 93 *Yale LJ* 1197, or shareholders proxies, as in RC Clark *Corporate Law* (1986) pp 374-83.

5 Examples of this kind of focus include; RC Clark *ibid* pp 684-8; J Braithwaite "Enforced Self Regulation: A New Strategy For Corporate Crime Control" (1982) 80 *Michigan L Rev* 1466; B Fisse "Techniques of Preventative Law for Minimising Exposure to Criminal Liability" *The Criminal Liability of Corporate Officers-Managing the Legal Risks* Sydney University Continuing Legal Education Seminar (1987); B Fisse *Howard's Criminal Law* (1990) pp 589-617; B Fisse "Corporate Compliance Programs" Trade Practices and Consumer Law Conference (16 September 1989).

implementation techniques designed to achieve this. The third set of arguments has focused on whether there should be a general duty or entitlement, on the part of management making corporate business decisions to consider non-member interests in the absence of specific legal regulation aimed at protecting those interests.[6] The substantive welfare considerations which have been suggested as appropriate for this sort of CSR involve a broad range of non-shareholder interests. At one end of the spectrum are those direct participants in the company operations, such as workers, creditors and consumers. At the other end are interests unrelated to company operations such as those involved in charitable gifts. In between are public concerns which business operations may impact upon, such as the environment, the industry in which the company operates and community interests. The most conservative example of this form of CSR does not require any departure from the present legal position. It would allow corporate managers to consider non-member interests when those interests can be aligned with long-term corporate profit, even if they are not compatible with short-term profit maximisation.[7] On the other end of the spectrum are those who would allow corporate managers to consider non-member interests even when those interests are unrelated to either long or short-term corporate profit.[8] Those who support this perspective would see CSR as involving a revision of the profit making orientation of the company in order to incorporate broader social objectives, traditionally thought to be within the province of government. In between these two extremes are those who would advocate "altruistic capitalism"; in other words, the idea that there should be a duty on corporate managers to extend the range of profit-making options the company has and to select from that range a course of action which will best

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6 One concrete manifestation of this perspective is the proposals for the representation of constituencies affected by the corporation within its decision-making apparatus; see for example, LCB Gower note 1 *supra* pp 63-75; OE Williamson "Corporate Governance" (1984) 93 *Yale LJ* 1197.

7 Labelled "agent-of-capital social reponsibility" in MN Browne and AM Giampetro "The Socially Responsible Firm and Comparable Worth" (1987) 25 *American Business Law Journal* 467. An example of this form of CSR would be a firm investing in environmentally friendly production processes in order to capitalise on environmental awareness in the purchasing public and boost product sales.

8 MN Browne and AM Giampetro *id*, call this "agent-of-society social responsibility". Two examples of this third variant which involve some modification of the profit objective are contained in s 4 of the *State Owned Enterprises Act* 1986 (NZ) and in a clause under consideration by the American Law Institute. Section 4 requires every New Zealand state owned enterprise to operate as a successful business. Success is defined as being measured by profit and efficiency, good employment practices, and a sense of community responsibility. The latter is to be achieved "by having regard to the interests of the community in which [the enterprise] operates and by endeavouring to accomodate or encourage these when able to do so." The clause under consideration by the American Law Institute provides that:

> A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business: (a) is obliged, to the same extent as a natural person, to act within the boundaries set by law; (b) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and (c) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

maximise the interests of all those affected by the decision.[9] The fourth, and related, variant of CSR is focused on reducing the negative externalities of corporate operations. Negative externalities are those costs of doing business which the company is not forced by the market to internalise. Strict profit maximisation, in most cases, would dictate taking advantage of market failure in the absence of legal regulation designed to correct the failure by prohibiting the conduct in question. CSR in this sense would require that corporations themselves isolate and take action to internalise, those costs of doing business which both the market, and the lack of legal regulation permit them to otherwise impose on others.[10]

It is the latter two variants that pose the most interesting questions for company law because it is they that represent the greatest deviation from the current legal position. Given the diversity of understanding within these two interpretations of what CSR means, the best possible overall definition of the concept is that it involves, to some degree, the harnessing of corporate resources to identify social problems and evolve or enforce solutions to them.

B. THE PUBLIC/PRIVATE MODEL INFORMING THE DEBATE ON CSR

Underlying the debate over whether CSR is a feasible concept has been a perceived differentiation between two central but separate spheres of values and activities in society. The first is the realm of government and politics. To this sphere belong issues which involve the formulation of social policy enuring to the collective good. The second sphere is that of business and economics which focuses on economic prosperity and financial considerations.

In the private sphere the market, by the forces of supply, demand and competition, determines what allocation of resources best maximises economic

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9 While the exercise of broader skills of social assessment will not always result in decisions which favour the firm, C Stone note 2 *supra* at 568 points out that:

> In the life of the enterprise, there are many occasions in which the managers have no "most profitable" option lying on their desks. Considering the uncertainties in any business environment and the limited data available to it, there will be some range of choices all equally consistent with that ill-defined and elusive favourite of the economic textbooks, the investment uniquely calculated to maximise shareholders' wealth.

He concludes at 569, that it requires commitment and effort on the part of the managers to expand the range of "profit undifferentiable choices" and that:

> ... the more prepared corporations are to search out and morally assess this profit-undifferentiable space, the more opportunities they might discover for corporate egoism...

10 An example of this fourth variant in the environmental area would be the imposition of a requirement on companies that they meet certain size stipulations and make regular social and environmental audits. Audits could also be required before any major new undertaking or project is engaged in. This could be combined with the imposition of liability for all those reasonably forseeable, major environmental harms which could have been avoided or minimised by a responsible prior assessment of the facts. Incentives to conduct such an assessment, or to ensure the quality of the audit undertaken, could be provided by making the offence one of strict liability and by allowing a defence wherever the audit in question contained a reasonable assessment of the potential dangers and risks, and satisfactory measures to minimise those dangers were implemented.

efficiency at any given point in time. Society's consensus is thus expressed in the market place.[11] Private sector decision-making is characterised by the need to meet a single major objective to which others become subordinated. Achieving the major objective is simplified by not needing to consider external issues beyond the trading of goods and services. All the factors in the decision can be theoretically estimated and taken into account. Each option can be subjected to cost-benefit analysis, with the most efficient or effective option being chosen. Private sector decision-making is thus efficient and readily adaptable. The modern corporate structure has evolved in order to enable large scale ventures involving numerous participants to utilise this form of decision-making. The separation of ownership and control in today's large company does not detract from its utility because managerial discretion which might be used to further objectives other than that of profit maximisation is held in check by the interplay of a variety of devices:

- Company laws and procedures contained in statute and case law which require managers to make decisions in the best financial interests of the corporation (traditionally identified with the shareholders);
- Market incentives and disciplines manifested in capital, share, managerial, commodity and corporate control markets;[12]
- Internal overseeing.

Despite this it has long been recognised that the market place produces negative externalities and cannot distribute sufficient goods in the community in a manner consistent with the values and standards of that community. It also does not produce "public goods". Public goods do not have ownership rights which can be readily enforced and use which can be easily monitored. Thus the public sphere, in the form of government, advances the collective welfare by providing an infrastructure for business, public goods, and regulation designed to correct market failures in the distribution of social goods, wealth and negative externalities. Public sector decision-making involves the balancing of complex political preferences, administrative feasibility and financial viability. Such a process is arguably subjective and qualitative and therefore slow and uncertain in result. The electoral process, by which government is kept accountable to the social consensus, is loose and the administrative bureaucracy ponderous and unwieldy. Efficiency and ready adaptability are not, as a result, necessarily features of public sector decision-making.

The fundamental misconception involved in attempting to allocate corporations, particularly large corporations, to either the public or the private

11 There is some debate on whether market indicators ever provide an adequate proxy for social welfare. For a discussion of this issue in so far as it relates to the question of CSR see C Stone note 2 *supra* at 570-3.

12 Some argue that private sector disciplines (those based on the market) are the most effective check on self-interested use of managerial discretion. Even so, it is acknowledged that they allow some margin before taking effect due to time lags, transaction costs, and defensive techniques. See RC Clark note 4 *supra* pp 180-9.

sphere is that the distinction between the spheres does not represent a clear dichotomy. The relationship between the two is symbiotic and companies necessarily impact upon and operate in both. Most modern western capitalist economies are corporate systems. Control of the factors of production and distribution is to a large extent vested in the hands of privately appointed managers. Managers can determine such fundamental social matters as the rate and direction of capital investment, technological innovation and product differentiation. Corporate business operations shape the economy and the structure of society.[13] Organised together they comprise a powerful political lobby group. The public sector has a correspondingly strong impact on the private sector in shaping the regulation of the market and controlling the factors of production. It is similarly unrealistic to view forms of accountability as separate. Today's corporate executive is not solely accountable to the shareholders. Instead he or she may be operating on two levels, achieving a delicate balance in attempting to satisfy, at times, contradictory goals and demands. The corporation is a social entity operating in the context of a wider social environment. Conversely the government may be heavily reliant on the business sector in its promotion of the economic and social prosperity of the nation.[14]

Those who are most persuasive in their objections to the concept of CSR do not deny this interconnection. Rather it is argued that it is impossible to incorporate elements and subjects of the public sector decision-making process into the private sector without incurring prohibitive costs in economic and allocational efficiency. In other words, there is still a qualitative difference between the types of decision-making processes involved.

The strongest argument in favour of CSR is that it has potential advantages as an alternative to traditional forms of regulation and that modified forms of the concept already exist effectively in the law. Viewed from the requirement that corporate managers consider non-profit and/or non-shareholder or broader social interests, CSR is evidenced in tort law,[15] regulation on social matters (such as environmental protection) and also operates extra-legally under the influence of anticipated regulation,[16] in the guise of public relations and in the

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13 Corporations are a major determinant of which social needs are met and which are ignored. See D Silverstein "Managing Corporate Social Responsibility in a Changing Legal Environment" (1987) 25 *American Business Law Journal* 523; S Beck "Corporate Power and Policy" in J Bernier, A Lajoie (eds), *Consumer Protection, Environmental Law, and Corporate Power*, Studies for the Royal Commission on the Economic Union and Development Prospects for Canada (Vol 50, 1985) at 182.

14 HJ Glasbeek "The Corporate Social Responsibility Movement - The Latest in Maginot Lines to Save Capitalism" (1988) 11 *Dalhousie LJ* 363 at 398.

15 S Shavell "Liability for Harm versus Regulation of Safety" (1984) 13 *Journal of Legal Studies* 357; W Schwartz "Products Liability, Corporate Structure and Bankruptcy: Toxic Substances and the Remote Risk Relationship" (1985) 14 *Journal of Legal Studies* 689; JA Siliciano "Corporate Behaviour and the Social Efficiency of Tort Law" (1987) 85 *Michigan L Rev* 1820.

16 D Silverstein note 13 *supra*, discusses this aspect. He argues that a corporate manager who engages in dynamic decision-making will be more competitive than one who does not. Dynamic decision-making he defines as decision-making which takes into account a changing legal environment.

form of sensitivity to the community's political preferences as expressed through the market place. It has also made a cautious debut in the case law where increasingly the interests of the company have been held to encompass those of the creditors, at least in situations of near insolvency.[17] Much of the debate which has raged passionately backwards and forwards on the desirability and feasibility of CSR is rendered somewhat superfluous when this simple observation is made.

CSR in response to public opinion as expressed through the market place has attracted little controversy because it does not interfere with prevailing legal or economic models of the corporation or of the role it plays in society.[18] While this form of CSR, when successful, is possibly the most effective means of producing real changes in the corporate culture, this article will be primarily directed towards the use of CSR as a law reform strategy. Part II examines why CSR is on the law reform agenda. It suggests that the concept will continue to receive attention because, at least in theory, it promises to redress some of the failures of traditional rule-orientated governmental regulation in controlling harmful corporate behaviour. In Part III the arguments of those who suggest that CSR is unworkable in practice are outlined. It is concluded that while these arguments do not suggest that CSR is unworkable in all its forms they do mark out parameters which it might be appropriate to impose on the concept when using CSR as a law reform strategy. Part IV concludes by briefly touching on the relevance of the concept in the Australian context.

II. WHY THE CSR DEBATE?

This section will examine why the idea of obliging corporations to act in a socially responsible manner has appeal to so many people. It is proposed to emphasise those forms of CSR which are aimed at reducing the negative externalities of corporate operations.

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17 *Walker v Wimborne* (1976) 137 CLR 1; *Nicholson v Permacraft* (1985) 1 NZLR 242; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722; *Grove v Flavel* (1986) 43 SASR 410; *Jeffree v NCSC* (1989) 7 ACLC 556; *Winkworth v Edward Baron Development Co Ltd and Ors* [1987] 1 All ER 114; J Dabner "Directors Duties - The Schizoid Company" (1988) 6 *Co & Sec LJ* 105; LS Sealy "Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural" (1987) 13 *Monash Univ L Rev* 164; N Hawke "Creditors' Interests in Solvent and Insolvent Companies" (1989) *Journal of Business Law*; R Barrett "Directors' Duties to Creditors" (1977) 40 *Mod L Rev* 226; F Dawson "Acting in the Best Interests of the Company - For Whom are Directors Trustees?" (1984) 11 *NZULR* 68; RB Grantham "Recent Developments Concerning the Duties of Directors" (1988) *NZLJ* 437. As well as these particular extensions of the concept of "the company" to include constituents other than the shareholders it is clear that directors will be permitted to consider a range of other interests in so far as such consideration promotes the welfare of the company qua the shareholders. See for example, *Evans v Brunner Mond Co* [1927] 1 Ch. 359; *Hutton v West Cork Railways Co* (1883) 23 Ch D 654 at 670; *Parke v Daily News Ltd* [1962] Ch 927; *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288.

18 MW Browne and AM Giampetro note 7 *supra*.

A. WHY CORPORATIONS?

The debate about CSR is really a debate about business responsibility which has focused on the corporate form, particularly as it is manifested in large corporate ventures. The reason for this is that businesses run by corporations differ from businesses run by individuals in a number of ways.[19] Most importantly the corporation is the dominant means of doing business in contemporary society. It is a structure for the concentration of greater economic power and the medium for decisions which have a more significant impact on society than businesses run in non-corporate form. Furthermore, there is seen to be an increasing perception in the community that corporations, particularly larger corporations, have used the power that they have to impact upon society in a harmful way.[20] Any misuse of power is facilitated by a number of features peculiar to the corporation which have been justified on the basis that they enable the accumulation of such power for the ultimate benefit of society.[21] Most obviously, the separate legal entity doctrine, the emergence of large-scale corporate groups and the safeguards offered by limited liability present opportunities for those involved in wrongdoing to abdicate their legal obligations.[22] A further reason for the focus of the CSR debate on corporations is that such entities, at least officially, do not have the range of moral options open to private individuals. The corporation is a unique fiction which is ostensibly locked into a profit motivation. Unlike businesses run by private individuals none of the participants involved in a corporation may take responsibility for deviating from that motivation. By way of broad generalisation, shareholders may not interfere with business operations except on the grounds of a detrimental impact upon their economic interests.[23] Managers may not use their powers for purposes other than the profit interest of the company qua the shareholders.[24] Other constituencies[25] such as

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19 Originally the impetus for focusing on corporations derived from observing the separation between ownership and control in large corporations. See A Berle and G Means *The Modern Corporation and Private Property* (1932); JK Galbraith *The New Industrial State* (1967). If corporate profit was not, as a result, the overriding goal of corporate management then it was considered legitimate to ask them to use their discretion for the benefit of society rather than for themselves. For an overview of the discussion on this issue, including strong dissenting opinions, see P Redmond note 1 *supra* at 177-203.

20 For a discussion of this point in the Canadian context see HJ Glasbeek note 14 *supra*.

21 P Blumberg "Limited Liability and Corporate Groups" (1986) 11 *Journal of Corporate Law* 605.

22 A Freiberg "Abuse of the Corporate Form: Reflections from the Bottom of the Harbour" (1987) 10(2) *UNSWLJ* 67.

23 For a discussion of shareholders remedies see P Redmond note 1 *supra* chs 7 and 8. This is an over-simplification of the position because shareholders can, in certain circumstances, intervene to restrain wrongs done to the company, illegalities and breaches of the *Corporations Law*. Nevertheless it is clear that they cannot intervene in management decisions to influence moral choices made by the company. See P Redmond *ibid* pp 236-43; *NRMA v Parker* 11 ACLR 1.

24 For an overview of the leading cases in this area see P Redmond note 1 *supra* pp 347-485. While most of the cases in this area involve directors subverting the profit of the company for personal gain there are a few instances where the courts have overturned decisions made by the directors for more altruistic reasons. See for example *Parke v Daily News Ltd* [1962] Ch 927. An American case in point is *Dodge v*

consumers, workers and the general public have a diffused and indirect impact on corporate choices and rely on imperfect information about its activities.

B. THE BENEFITS OF CSR

Projects are suggested as appropriate for CSR in those areas in which there has been or is a strong likelihood of market failure in that the free market produces a result which fails to measure up to what is considered to be socially optimal. Because such failures are generally considered best remedied by government regulation CSR usefully adds something to the present position only if it effectively redresses deficiencies present in the regulatory process.

Traditional rule-oriented regulation suffers from a number of inherent defects in dealing with the negative externalities of corporate operations. These defects stem from the nature of the social problems generated; the corporation's superior knowledge and power vis-a-vis the government, the nature of the political process and the nature of legal rules. In theory the concept of CSR promises some advantages over this form of regulation in terms of speed, innovation and reduced informational distortion at three stages in the political process; first, in recognising the existence of externality problems, secondly, in designing appropriate measures to deal with those problems and thirdly, in enforcing remedial measures.

(i) The nature of the social problems generated

Legislation is premised on political recognition of a social problem and is primarily reactive rather than preventative. The difficulty with most social problems suggested as appropriate for CSR is that by the time they achieve political recognition they may have reached crisis proportions. This difficulty can stem from the fact that the interests affected are relatively powerless, diffuse, under-represented and uninformed. Thus, the very factors which generate a need for protection also prevent recognition through ordinary political channels. In the case of social concerns that involve expropriation of the communities durable infrastructure the problem may only appear once irreparable damage has been done.

(ii) Corporate knowledge and power

Corporations enjoy a monopoly over knowledge about and control over their activities. Sophisticated management systems and a superior command of capital and technology may also provide them with the potential to develop innovative solutions to novel and diverse externality problems.[26] Clearly they

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Ford Motor Co (1919) 170 NW 668. It is, however, clear that some measure of corporate altruism can be justified under the rubric of public relations and long-term profitability.

25 In situations of insolvency creditors are granted some rights for the protection of their financial interests, see ss 592-593 of the *Corporations Law* and the cases cited at note 17 *supra*.

26 Social and environmental impact analysis' are by their very nature difficult to make. The size and technical complexity of many large corporate ventures exacerbates the problem.

are in a better position than the government to identify and deal with the negative externalities that their activities create.

When social problems are generated by corporate activity the government is partially reliant on corporate cooperation and information in identifying and dealing with them. Corporate incentives that are purely economic generate an adversarial attitude towards governmental intervention that interferes with profit maximisation. Such incentives also produce behaviour that capitalises on the numerous opportunities which corporations have to conceal or distort information which must be disclosed to government agencies.

Glasbeek[27] provides a more disturbing critique of this situation. He suggests that in Canada regulation has not and will never effectively redress the problems created by corporate activity because of "capture" of the government by large dominant corporations.

(iii) The nature of the political process

Professor Weiss[28] highlights three kinds of deficiencies in the public decision-making process that prevent regulation from being effective. The first are informational problems. These encompass problems stemming from the nature of the social concerns in issue and the corporations monopoly over knowledge of its activities. But they also include the fact that government agencies have codes that screen out information that does not seem directly relevant to their functions and an attitude that Weiss describes as "the government is best that governs least", indicating a reluctance to disturb the market equlibrium. As a result the government rarely identifies a problem in its early stages and is limited in imaginative responses.

The second are political problems. Because political representatives are dependant upon re-election they tend to avoid political risk by being instrumentality orientated and focusing on short-term goals. Problems must reach crisis proportions to appear on the political agenda and responses are likely to be non-interventionist and unpredictable. Barriers to change are also suggested to result from a perception politicians have of themselves as referees in conflicts among interest groups which means that regulation tends to be reactionary rather than the result of a coherent set of public policies designed to deal with social and economic problems.

The third are implementation problems which result from the fact that relations between regulatory agencies and corporations tend to be adversarial in nature, regulatory agencies are motivated by bureaucratic norms that may not coincide with regulatory goals, regulatory decisions lack administrative flexibility, and civil and criminal sanctions available to regulatory agencies do not impress corporate decision-makers. The result of these features in turn generates further problems. First, regulatory standards are not sensible.

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27 Note 14 *supra* at 398. He argues that the function of the debate, in spite of its innovative flavour and intuitive appeal, is to perpetuate the status quo.

28 Note 2 *supra* at 378-90.

Externality effects are based on inaccurate and incomplete information. Secondly, enforcement problems may be generated or exacerbated by massive resistance or tokenism. Thirdly, many serious problems may simply not be addressed or may take years before they are dealt with. The outcome is a diversion of regulatory programs from their objectives, the generation of large spillover costs and substantial non-market failures.

(iv) The nature of legal rules

It is generally recognised that legal rules by their very nature suffer from some inherent defects.[29] First, they generally fail to remedy harms which occur before the legal remedy is put into place. Irreparable damage may be caused prior to that stage and corporate resources may be committed in the pursuit of a particular course of conduct that is prohibited or rendered unprofitable by subsequent regulation. Secondly, typical regulation employs "bright line" standards. This results in an emphasis on form not substance and tempts actors to test the limits of what is legally permissible. The profit making incentive structure of the corporation and the adversarial stance taken towards market intervention encourage this attitude. Thirdly, it is impossible to predict in advance the complexities of any particular situation, unforseen contingencies, the range of potential activities and possible harmful outcomes. Paradoxically while these limitations produce the significant risk of underdeterence there is also a possibility of overdeterence.[30] The possibility that socially productive activity will be discouraged stems from the failure to draw a flexible balance between "detering hazards and encouraging innovation." This failure is inherent in the process of laying down general standardised rules. Finally, because the law does not involve internalisation of values or responsiblities it carries high monitoring and enforcement costs. However, resources available for enforcement are limited and therefore the law, to a large extent, depends on "obedience and compliance with what would otherwise be unenforcable."[31] These problems are exacerbated if insufficient thought and planning results in unimaginative legislative solutions to problems, reactionary, poorly drafted legislation or legislation which is not subject to regular review.

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29 C Stone note 2 *supra* at 567-8.

30 This paradox results from the inaccuracy involved in attempting to provide comprehensive advance rules to govern behaviour.

31 J Mckie "Changing Views" *Social Responsibility and the Business Predicament* (1974). This difficulty with governmental regulation may create severe problems in environmental law where outdated and grossly inefficient penalties can be an acceptable cost for companies choosing to pursue an economically profitable but illegal course of action. For examples of the consequences this attitude may have see The New Zealand Interagency Co-ordinating Committee on Hazardous Substances Working Group *Hazardous Substances Management* (1987) pp 22-3.

CSR, if it can be implemented in an effective manner, does in theory promise advantages[32] over traditional rule-orientated government regulation. Potentially it offers the following benefits:

- Speed of response to diverse and novel corporate externality problems by minimising the necessity for political recognition of the problem as a problem.
- An emphasis on preventive measures rather than remedies and thus the minimisation of irreparable harm, crises situations and the commitment of corporate resources to those ventures about which a responsible assessment of the facts would reveal large negative externalities.
- The imposition of liability on corporations for a failure to respond to harms which occur before specific legal remedies are put into place.
- The accuracy and flexibility associated with a response that involves assessment of particular situations. A focus on factual context rather than the application of inflexible rules reduces the risks of overdeterence of socially beneficial conduct and underdeterence of harmful activity.
- Utilisation of the corporations superior resource base in terms of information, control over its operations, capital and technology.[33]
- The encouragement of innovative and cost effective solutions to problems.
- An emphasis on substance over form and therefore the encouragement of caution by reducing the temptation to take an overly formalistic approach to the question of what is legally permissible.
- The fostering of internalised values and responsibilities and the promotion of a closer working relationship and exchange with the government. A corresponding reduction of selective corporate disclosure and distortion of information. A reduction of strain on governmental resources in respect of monitoring and enforcement costs, under-enforcement because of that strain, and implementation errors.
- The shielding, to a certain extent, of real concerns from policy switches, equivocation, political capture and political capitalisation associated with the process of government regulation.

The extent to which these suggested benefits can be taken at face value is unclear. If CSR is itself implemented by regulation then it will suffer, although to a lesser extent, from some of the problems inherent in the regulatory process. Furthermore, if one accepts Glasbeek's[34] argument that regulation has been

32 These advantages obviously do not include greater predictability of response to indentified problems or the prevention of capture by interest groups, under-representation of diffuse interests and role-playing.

33 It also encourages the development of expertise and skill in employing these resources in the public interest; see K Piddington "The Ethics of Environmental Engineering" (1984) 18 *New Zealand Engineering* 20.

34 Note 14 *supra*.

ineffective because the government "is in a position to be influenced, constrained and even intimidated by a closely connected and single-minded business elite" and that the movement to promote CSR is an attempt on the part of such an elite to avoid the next logical deduction from this proposition, the breaking down of their economic and political control, then any benefits promised by CSR are illusory or, at best, temporary.

It is also worth noting that reliance on public activism to generate CSR produces a set of further problems. Because incentives for CSR are linked to the company's long term profitability via the medium of public relations, the extent to which corporations engage in responsible behaviour depends on their visibility to the public as members of the business community and their vulnerability to public criticism.[35] These incentives will be diffused in the case of monopolies and firms not selling directly to the public. They will be minimal when public opinion is not sufficiently informed or activated to take a stance on the issue.[36]

CSR as implemented by the judiciary is probably the least attractive option available. The nature of the process of evolving principles as issues arise in particular cases, and the expressed reluctance of the courts to be seen to be interfering in business decisions[37], mean that reform via the common law process is unlikely to be speedy, consistent, certain, or comprehensive.

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35 JAC Hetherington "When the Sleeper Wakes: Reflections on Corporate Governance" (1979) 8 *Hofstra L Rev* 183 at 189.

36 General fiduciary doctrines do at present allow management some leeway for the implementation of social goals. However they have serious deficiencies if relied upon as a medium for dealing with the negative externalities of company operations. Most importantly fiduciary obligations provide no incentives for responsible action. At best the managerial leeway afforded under the doctrines can be interpreted as permission to engage in socially responsible behaviour to an unindentified extent. There are a number of other problems involved in reliance on fiduciary doctrines. First, to the extent the doctrines do permit CSR they also disguise the policy choices being made, the factors influencing those choices, and the information on which they are based. There are few disclosure or reporting requirements which might impact upon this proposition. Secondly, to rely on the leeway afforded by fiduciary obligations is to rely on a method that is indirect and inexplicit. The limits of the rules are subject to considerable uncertainty. On the one hand it is suggested that the fiduciary doctrines are limited in operation and usually interpreted in a conservative fashion, see RC Clark note 4 *supra* p 681. On the other hand it is suggested that the doctrines provide no greater restraint than if there was an explicit recognition that managers can give away corporate assets to a reasonable extent, see RH Mundheim "A Comment on the Social Responsibilities of Life Insurance Companies as Investors" (1975) 61 *Vanderbilt L Rev* 1247 at 1258. On the latter view the doctrines are deficient in that they provide no standards for managerial action and therefore encourage the implementation of personal policy preferences. A related objection is that the doctrines provide no system of accountability or control. Both these objections are diminished by the extent to which market discipline operates as a control on managerial behaviour. See DR Fischel "The Corporate Governance Movement" (1982) 35 *Vanderbilt L Rev* 1259 at 1288; RC Clark note 4 *supra* pp 136-40; SS Arsht "The Business Judgement Rule Revisited" (1979) 8 *Hofstra L Rev* 93.

37 See for example *Re Smith & Fawcett Ltd* note 3 *supra*.

III. IS CSR A FEASIBLE LAW REFORM OPTION?

This section will examine arguments about whether CSR is a workable concept. Despite reservations about the value of the distinction between 'public' and 'private' it is proposed to structure the following discussion in the context of that perceived differentiation.[38] In both spheres the two primary issues are feasibility and legitimacy. The question of whether CSR is feasible in the public sphere turns on whether the corporation, in formulating and implementing social policy, will detract from the effective performance of the government in regulating social problems. The question of feasibility in the private sphere turns on whether CSR is compatible with the efficient operation of the market place and whether corporate managers have the expertise to pursue broad social objectives. The question of legitimacy in the public sphere turns on whether the corporation is an appropriate mechanism for formulating policies which reflect the collective good of society; in other words, undertaking the process of government. In the private sphere the question is whether managers are the appropriate agents to defeat the shareholders reasonable expectations by disposing of corporate assets, which are private property, in the public interest.

If the concept of CSR is assumed to be a general mandate on the part of corporate management to define and engage in socially responsible behaviour, even if such behaviour is not linked to company profit, then arguments against its introduction are overwhelming. But the more it looks like a regulatory issue, that is, the legislature attempting to harness corporate resources in the process of either isolating social problems and evolving or enforcing solutions to them, then the weaker these arguments become in theory. Even so they underline the need for particularity on the part of the government in identifying precisely what is hoped to be achieved by relying on the corporate sector and in tailoring implementation techniques to achieve those goals. This last point highlights one of the most obvious problems with the level of abstraction on which the debate we will be canvassing has been conducted. At this level it can never be more than an introduction to the more difficult and creative task of actually giving the concept of CSR concrete shape.

A. FEASIBILITY

(i) The public sphere

A number of objections to the concept of CSR are based on the view that its introduction into the private sphere will detract from the efficient operation of the public sphere. Clark[39] suggests that the effective creation of a number of mini-governments acting independently to define and implement government policy will render implementation "more incoherent and uncoordinated than it is

38 Primarily this is a matter of organisational convenience given the historical form of the debate.

39 Note 4 *supra* p 694.

now". This argument clearly rests on a perception of CSR as replacing or usurping the governmental function of balancing different interests in society and formulating overall coherent policies. Instead this task will be delegated to individual corporate entities who, because of the subjective and qualitative nature of the task, will act in analogous situations in unpredictable ways. A corollary of this argument is that reform or action via the medium of decentralised choice disguises the need for and thereby hampers effective overall social reform. It "puts a costly drag on changes that eventually ought to be made".[40] A final argument is that individual action via CSR prevents the legislature from enacting law by silence. The failure to provide remedies to social problems may result from a perception on the part of government that the social cost of preventing action (or requiring remedial action) exceeds the social benefit of the activity in question. It is a waste of legislative resources to require endorsement of every informed decision not to disturb the status quo.[41]

The assumption underlying these arguments is that CSR necessarily entails a completely general mandate to corporate management to define and engage in socially responsible behaviour. If it means instead that corporate resources are utilised as part of a coherent overall governmental policy precisely because reliance on the corporate sector supplements the rigidity inherent in traditional rule-orientated governmental regulation then these arguments lose much of their persuasive force. Furthermore, in so far as this process might actually foster greater co-ordination and information exchange between the corporate sector and the government, it may, in fact, enhance the government's ability to engage in comprehensive social planning based on a realistic assessment of the extent and results of corporate activities. For similar reasons the argument that CSR prevents legislation by silence must be rejected. If the legislative mandate to corporate management has been carefully constructed it is unlikely to conflict with those areas where the legislature feels it necessary to endorse the status quo by inaction.

B. THE PRIVATE SPHERE

(i) The lack of corporate resources and the imposition of high agency costs

One of the strongest objections to CSR lies in the fact that managerial training, expertise and accountability is financial and 'apolitical'. As a consequence incentives are also economic. This has two implications. First, it is questionable whether managers have the capacity to engage in social assessments. It is argued that the social consensus is "a clear and powerful

40 *Id.*

41 JL Mashaw "Corporate Social Responsibility: Comments on the Legal and Economic Context of a Continuing Debate" (1984) 3 *Yale Law and Policy Review* 114. Mashaw points out that there is often a discrepancy between what is in fact wanted and what is talked about as socially acceptable behaviour. This dichotomy reflects the fact that there are, in certain situations, conflicting values with different weightings attributed to each.

directive" to corporate managers to respond to market demands.[42] Experience and training gives management particular expertise in interpreting and implementing this objective. It gives them no expertise in determining what is a politically or ethically correct social stance or in undertaking the complex and uncertain cost-benefit analysis involved in formulating such a stance. Secondly, disturbance of the present equilibrium may result in high agency costs and decreased economic performance by the company. Because management remuneration is linked to, and managers are accountable for, the financial performance of their company they lack the incentives to pursue broader social objectives[43]. In order to give managers such incentives it is necessary to shield them from derivative law suits and competition in productive markets. But to loosen such controls would do more harm than good because managers would then be free to use their powers for their own personal benefit. A related point is that the private instruments[44] through which managers are made accountable are triggered automatically by the standards implicit in the profit maximisation objective. This single objective goal is easily monitored and provides a clear measure for managerial performance.[45] There are no criteria to replace market standards for judging the propriety of wages, prices, and general corporate performance.[46] The sum total of all these arguments is to postulate that a low level of performance can be expected in terms of social and economic objectives if CSR is introduced.[47]

Again these arguments carry greatest force with respect to the broadest interpretations of what it is that CSR means.[48] What the existence of a significant risk of disturbing the market equilibrium primarily emphasises is the importance of introducing the concept only in those areas where the public interest in social welfare sufficiently outweighs the public interest in private profitability to justify some decrease in private efficiency.[49] It also highlights the necessity of being specific in determining the objectives sought to be

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42 D Engle note 2 *supra*.

43 Except to the extent permitted by the slack in accountability and dictated by the 'physic income' they might gain from doing so; JAC Hetherington note 35 *supra* at 189.

44 Market incentives, disciplines, and internal overseeing. Also relevant are the legal duties owed to the company which require directors to make management decisions bona fide in the best financial interests of the company.

45 The position is complicated by factors such as inefficient markets, the introduction of long-term profit considerations and uncertainties in the law as to the scope of directors duties.

46 RC Clark note 4 *supra* p 679.

47 *Ibid* p 693.

48 Although they do present a strong caution in respect of other interpretations of CSR that involve modification of the profit objective. In the words of Professor Stone note 2 *supra* at 573-4:

> It is, however, one thing to suggest the existence of situations in which we would want managers to introduce nonprofit side-constraints. It is quite another thing to be able to implement such an influence... By injecting multiple, competing constraints into the organisational environment there is a risk that the corporate reformers... are obliged to acknowledge. In our pursuit of some elusive ideal, we risk diverting corporate managers from their principal mission - from what they do best.

49 For example, isolating those social concerns in respect of which there has been significant market failure in that social costs are not reflected in the actual price of goods and services.

achieved by CSR and in tailoring the concept, including standards of behaviour, towards those objectives. Implementation techniques do exist in areas such as tort law, where flexible, factually orientated duties are imposed on the company, which may enable problems with incentives, standards, and managerial accountability to be overcome.[50]

To simply say that managers lack the expertise to take social considerations into account does not defeat the argument that they ought to develop such skills, particularly where their peculiar position in relation to company operations renders them uniquely suited to exercise those skills effectively.[51] It is possible that, in fact, the situation is reaching a stage where managers are no longer able to avoid developing broader skills. As both Baxt[52] and Stone[53] point out there is an ever expanding body of legislation that requires directors to take into account environmental, health, and other public interest criteria. In addition, managers are increasingly required to assess a range of other interests and the public relations of the firm when deciding on the most profitable course of action available to the company in any given instance. According to Baxt, so far as public and larger companies are concerned it is unreal to suggest that directors, in assessing the activities of the company, do not take into account a multitude of interests - the interests of creditors, the financial position of the company and the potential claim of creditors in situations of tight liquidity, the claims of employees, the interests of the company with respect to the export trade, the needs of the economy, and the various obligations of the company in a social context.[54]

The reality of the position clearly is that it is no longer possible to claim that assessing profit maximising courses of action is a purely financial exercise. Even in those situations in which the choices available to the company are profit differentiated, long term considerations are entered into, and change the short term mix.[55]

(ii) Corporate Survival in the market place

It is argued that CSR is incompatible with competitive markets.[56] Because the concept involves subjective and discretionary judgements competition in the

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50 Note 15 *supra*.

51 D Silverstein note 13 *supra*.

52 Note 1 *supra* at 302.

53 Note 2 *supra* at 563-4.

54 Note 1 *supra* at 301.

55 Apart from the implicit realities of the situation some firms are explicitly developing codes of ethical guidelines for employees and fostering a climate, within the company, for making ethical decisions. Companies such as Control Data, Xerox, and Johnson & Johnson are but a few American examples of companies engaged in the task of demonstrating that it may be possible to provide a workable and practical set of considerations for behaviour that goes beyond strict profit maximisation. See D Rockefeller "Ethics and the Corporation" (1979) 8 *Hofstra L Rev* 135; D Rockefeller "Executive Ethics: Doing Business, Doing Good" *New York Times* (3 January 1988).

56 R Posner in *Economic Analysis of the Law* (1977) pp 310-13, argues that in "competitive markets a sustained commitment to any goal other than profit maximisation will lead to bankruptcy unless

market will continue to dictate the quality of the decisions made. Therefore most firms will continue to make profit oriented decisions. Those firms that do attempt to behave in a socially conscientious fashion will be less profitable and will either be forced out of business or will present the most attractive subjects for takeover bids, leaving those less so to prosper.[57] In order to promote CSR it is necessary to reduce financial competition in the market and this entails a corresponding decrease in efficiency. Mashaw elaborates on this analysis; market discipline converges on the firm through at least three markets - product markets, capital markets and labour markets. If we assume that all of these markets are competitive, the individual firm faces precisely the same marginal cost function as its competitors and a highly elastic demand for its products. When it engages in CSR, it must therefore either raise its prices and face a drastic decline in demand for its products, or it must reduce the returns to capital and labour. Reductions in the returns to either will, over time, cause the firm to fail to attract the necessary financing and talent to survive in the market place.[58]

Whether a firm has the power in any particular market to engage in CSR and still profit depends on whether the firm has a dominant position in that market. Thus, Mashaw does not argue that CSR is incompatible with the market as it operates in practice just that, either it should be the model for those firms that have the power to engage in CSR ("selective CSR") or that some program of structural reform be instituted to render markets selectively non-competitive when CSR activity is desired ("global CSR").[59]

Allowing the market to dictate the limits of the use of CSR in this respect is to forget that it is precisely in respect of public concerns, that is, those assets and services in respect of which there has been market failure, that the concept of CSR potentially becomes useful. In respect of negative externalities it is also to forget that if the market prices of goods and services do not reflect the actual social cost of producing or providing them then demand will exceed that which optimises social utility. Even on the assumption that competitive markets do exist, objections based on these grounds simply counsel caution. They underline the importance of determining where the public interest in broader social concerns may outweigh the public interest in private sector efficiency and call for specificity in tailoring the concept to promote those concerns. They also demonstrate the desirability of utilising those means of implementing CSR

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collusion is permitted." He suggests that the situation will be the same in monopolistic markets if monopoly rents happen to be eaten up by the fixed costs of entry. He points out that there are no "profits in an economic sense, only accounting profits which are equivalent "to the cost of attracting and retaining capital in the business."

57 It is worth noting that arguments along these lines may understate the extent to which corporate operations impact upon and shape public opinion and market demands. See KN Wedderburn note 1 *supra* at 13; G Goodpaster "The Challenge of Sustaining Corporate Conscience" [1987] 2 *Journal of Law, Ethics and Public Policy* 825.

58 Note 41 *supra* at 115.

59 *Id.*

that disturb the market equilibrium to the least extent possible as, for example, by harnessing public opinion as expressed through market mechanisms or imposing uniform standards that make use of known and workable concepts, such as those existing in tort law.

(iii) The extent to which the market adequately makes provision for CSR

It is also argued by some that there is far more consistency between profit maximisation and the pursuit of broader social goals than is generally assumed. That is, the market as it currently operates allows corporate management considerable leeway to engage in CSR.[60]

A simplistic version of this argument points out that other goals, such as safe working conditions, are sacrificed precisely when profitability is threatened.[61] A more sophisticated argument points out that profit maximisation gives management significant lattitude because many CSR expenditures can be justified in the name of public relations and thus brought under the rubric of the general fiduciary obligations imposed on directors to act in the company's best interests.[62] Society's attitude thus ensures responsibility in the long term. Furthermore, social objectives are expressed through the medium that managers have the training and expertise to interpret. Another version starts by rejecting the principle of competition as being very significant in the debate about corporate altruism because most large corporations compete, at least partially, in oligopolistic markets. Rather, the essential economic limit on voluntarism "is the level of altruistic activity at which, were an outsider trying to wrest corporate control from the current managers and eliminate the altruistic practice, his [sic] expected gains from doing so would exceed his [sic] costs."[63] This will depend largely on whether the costs of altruism can be passed on to the customers and the costs of implementing a takeover. The less competitive the product market the more the cost will be born by the firm's customers rather than the shareholders and the higher degree of altruism which can be practiced before rendering it worthwhile for an outsider to attempt to displace current management. It follows from this analysis that, in the case of large public companies, conditions allowing substantial managerial voluntarism in the course of operations are likely to be present today. Many such corporations do compete in oligopolistic product markets, most forms of voluntarism in the course of operations may be expected to raise marginal costs at least to some degree, and it is generally very expensive to displace the management of a publicly held corporation.

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60 The essential supplement to all these arguments is that where the market is deficient in providing for social concerns or protecting the interests of non-shareholder groups governmental regulation will rectify the situation.

61 DR Fischel note 36 *supra* at 1269.

62 RH Mundheim note 36 *supra* at 1250.

63 RC Clark note 4 *supra*.

While these arguments are of assistance in demonstrating that CSR is not incompatible with the market as it operates in practice they do not form a sufficiently strong justification for allowing the status quo to stand. Simply concluding that the market allows for CSR is not the same as demonstrating that it actually occurs.[64] Furthermore, it is not enough to argue that the market presently provides adequate leeway for CSR without assuming that all CSR is either a good or a bad thing and therefore that which can be achieved in practice is indiscriminately good or bad. CSR is a tool which can be used to achieve public goals and is not an end in itself.

(iv) Discouragement of investment

It is argued that CSR increases the uncertainty of returns because of decreased managerial accountability and efficiency. It will therefore discourage the public from investing and participating "in large organisations which as a whole increase public welfare by large scale ventures".[65] Williamson[66] develops this argument. He points out that transactions which enjoy no safeguards contain a risk premium because they are apt to be contractually unstable. This is particularly so when the parties involved must invest in transaction-specific assets to facilitate the proposed exchange of goods and services. Therefore, unless constituencies with exposed assets are provided with safeguards they will demand a higher rate of return. If firms which do engage in CSR are less profitable there is a significant possibility that they will not be able to provide shareholders, lenders, creditors, and other constituents with the risk premiums which their conduct necessitates in order to attract contributions.

At the risk of being repetitive these arguments simply call for techniques designed to introduce CSR without a correspondingly unacceptable expansion of managerial discretion.[67] In respect of negative externalities it is also worth reiterating that companies internalising such costs will have decreased profitability generally because they are paying, or passing on, the real costs of production.[68]

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64 That there is leeway for CSR does not demonstrate that there are incentives for CSR. See JAC Hetherington note 35 *supra*.

65 RC Clark note 4 *supra* p 3.

66 Note 6 *supra* at 1209-1211.

67 This could be achieved by making standards and objectives as specific as possible and providing a coherent global method of enforcement.

68 That there is some investor demand for "ethical companies" is evidenced by the establishment of several funds in Australia which specifically promote investment in such companies. One example is the Friends Investment Management Limited's "Ethical Growth Trust".

C. LEGITIMACY

(i) The public sphere

A significant proportion of the literature discussing CSR presents the argument that certain functions are inherently political and cannot be legitimately delegated to private institutions such as public corporations. The public functions referred to appear to be characterised in both a specific and a general sense. In the narrow sense it is argued that CSR mandates corporations to usurp the inherently governmental function of wealth redistribution or taxation.[69] This is because it allows managers to deprive individuals of financial benefits to which they would be entitled if private property and income had been allocated by normal market forces and to distribute those benefits to other entities. In the wider sense the governmental function referred to is the value judgement involved in balancing various interests in order to determine where the public interest lies (sometimes conceptualised as "interpreting the social consensus"). This process results in the formulation of political or social policy which reflects the collective good.[70] This definition of the function which is considered to be inherently governmental is broad enough to encompass the activity of taxation because of the questions of overall distributive justice that it presents.

The characterisation of certain functions as being inherently political is linked up with a conception of what it means to be a political body entrusted with the task of governance. Government in this society is viewed as a representative democracy.[71] Only through the government are all voices represented and can costs be levied on all for the collective good. Corporate managers, so the argument goes, are an illegitimate form of government which "reflects upper class preferences and is an oligarchy in disguise."[72] Thus, they cannot be expected to reflect the policy preferences of society in choosing its social objectives and the powers and means by which those are to be implemented. Nor have they been democratically selected by the political process. Another related concept is that of political accountability. A clear allocation of responsibility, whereby political judgements are left to the political process, is thought to make it easier to hold the proper institutions accountable for their failure to meet objectives.[73] For the government to assign its political role to large corporations is an abdication of authority leaving the public, if dissatisfied with the performance of that role, without political redress.

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69 M Friedman "The Social Responsibility of Business is to Increase its Profits" *New York Times* (13 September 1971) p 33; R Posner note 56 *supra* pp 310-313.

70 D Engle note 2 *supra* at 27.

71 M Friedman note 69 *supra*; EV Rostow, "To Whom and for What Ends is Corporate Management Responsible" in ES Mason (ed) *The Corporation in Modern Society* (1961) p 56; BW Lewis "Power Blocs and the Operation of Economic Forces - Economics by Admonition" (1959) 49(2) *American Economic Review* 384 at 395.

72 RC Clark note 4 *supra* p 693; D Engle note 2 *supra* at 30-31; M Friedman *Capitalism and Freedom* (1962) pp 133-137.

73 RH Mundheim note 36 *supra* at 1258.

Conversely, corporate managers are accountable primarily through private instruments. The means of holding them accountable are not available to the general public for good reason, namely, the decrease in efficiency that would result from unlimited opportunities to interfere with the expertise managers bring to bear in the pursuit of their primary economic objectives.

Implicit in all of these arguments is a perception of the corporation as an apolitical and economic entity. It is a social entity only to the extent that economic efficiency dictates its function in collecting and reconciling various private interests.

A number of people[74] attempt to counteract these arguments by accepting the dichotomy drawn between 'public' and 'private' and suggesting that today's large public corporations fall into the catagory of public; that they are in fact mini-governments or political institutions. Three main points emerge in argument[75]. First, such entities wield enormous social, political and economic power and thus impact upon and control vital resources and decisions that shape society. They are thus involved in a form of governance which, in a democratic community, ought to be legitimated by rendering them accountable to society. Secondly, that in so far as legitimacy is based on popular acceptance, society's perception of large corporations has changed as a result of the increased power they now wield and it demands accountability. Thirdly, corporations are, in fact, increasingly responding to political forces within society. Political forces are defined by Stevenson as:

> Those extrinsic influences on corporate behaviour, arising out of popular feelings, that are not expressed directly through the market mechanism.[76]

While these forces may have an economic aspect such as the desire to cultivate a favourable public image or the desire to avoid regulation:

> ... the calculus... is not related to the laws of supply and demand in the conventional manner in which most corporate economic decisions are made.[77]

There are five current theories which attempt to explain the legitimacy of the corporation as a political institution.[78] In the first, the power wielded by managers is legitimated by the control which shareholders as members of the public exercise via the corporate electoral system. Thus, corporate invasions of the public interest are to be prevented by managerial accountability to the shareholders as a body. Proponents of this theory support reforms of the corporate electoral system. In the second, large corporations are perceived as private governments with a body of constituents including all those upon whom

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74 P Blumberg note 2 *supra*; P Blumberg "The Public's 'Right to Know': Disclosure in the Major American Corporation" [1973] *The Business Lawyer* 1025; RB Stevenson "The Corporation as a Political Institution" (1979) 8 *Hofstra L Rev* 39; A Miller "A Modest Proposal for Helping to Tame the Corporate Beast" (1979) 8 *Hofstra L Rev* 63.

75 RB Stevenson *id.*

76 *Ibid* at 40.

77 *Ibid* at 41.

78 The following synopsis is taken from RB Stevenson *ibid* at 42-45 .

they impact. Proponents of this theory suggest that members of this broad group have a voice in corporate decision-making. In the third, the governmental character of the large corporation is derived from its close relationship with the state. Thus legitimation derives from "a growing assimilation of the corporation into the state." The fourth theory is that of "managerialism... in which can be found an implicit recognition of the political character of the modern corporation." It is argued that the corporate executive should "engage in 'leadership' and 'interest balancing' apparently guided largely by his or her own conscience, perhaps as it reflects the mores of society at large." The last theory is that of the "organisational behaviouralists" who suggest that managers of large corporations have never had profit maximisation as a single goal. "Instead they 'satisfice' juggling a complex mix of competing demands, many of them only remotely connected, if at all, with conventional economic considerations."

The literature on this subject is confusing. Not only are the concepts used[79] imprecise, but it is also difficult to discern a definitive theoretical structure which explains how they interact. For example, some proponents of the view that the public corporation is a political institution present evidence of politicisation as the means of fully legitimating the political power possessed. Corporations are political entities because they are accountable to society. Because they are political institutions we must make them more accountable to society. That the entire debate is conducted at cross purposes is evidenced by the extent to which the conclusion reached depends on the way in which the concepts used and the manner in which they interact is defined.[80] The concepts, 'public' and 'private', 'political' and 'economic', and the inter-relationships between these concepts, are malleable and therefore of little use in clinching the CSR debate.[81] Furthermore, the binary oppositions set up by the use of such words imply that the words describe differences in kind rather than degree in terms of the types of bodies and functions that they are applied to. That this is not the case is apparent from the fact that proponents of the view that the

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79 'Political', 'private', 'legitimacy' and 'accountability'.

80 See, for example, M Eisenberg "Corporate Legitimacy, Conduct, and Governance - Two Models of the Corporation" (1983) 17 *Creighton L Rev* 1; R Mangrum, "In Search of a Pardigm of Corporate Social Responsibility" (1983) 17 *Creighton L Rev* 21.

81 While the concepts of 'public' and 'private' are malleable and add little to the debate on CSR, their use does carry some normative value and has had practical implications as a result of the selective fashion in which they have been applied. The implications of viewing the large company as an essentially private entity are many. Some of the most important have been identified by WJ Samuels "The Idea of the Corporation as a Person: On the Normative Significance of Judicial Language" in WJ Samuels and AS Miller (eds) *Corporations and Society - Power and Responsibility* (1987) pp 119 - 120 as follows:

- Such corporations are freed from a theory justifying state intervention or external control. They are protected against arbitrary regulation;
- The emergence of large scale corporate concentration is seen as inevitable and a natural reflection of the rational economic tendency towards consolidation;
- Recognition of the corporation as a private government would lead to the imposition of the same checks as on the public government. As a private entity it is free from such control.

See C Stone "Corporate Vices and Corporate Virtues: Do Public/Private Distinctions Matter?" in *A Symposium: The Public/Private Distinction* (1982) 130 *Univ Penn L Rev* 1441.

company is a private entity and those that argue that it is a public body accept it as necessarily engaged in the process of balancing and reconciling various interests in society. On either view it is a social body responding to the social context in which it operates. It is therefore not possible to argue that simply because CSR involves a kind of balancing process it necessarily involves the illegitimate exercise of an inherently political function.

Even on the assumption that these dichotomies do exist and that CSR does involve a type of decision-making that is more akin to the formulation of public policy than its implementation, in other words a political decision-making process, this does not necessarily mean that it entails an illegitimate exercise of political power by private entities. If it is implemented by legislation then it may be viewed as a form of delegation by which the government indirectly selects its political objectives or at least determines that such decisions are more effectively made and implemented by a delegate.[82] As Eisenberg[83] points out legitimacy is an empirical rather than a deductive phenomena and the political process is rife with examples of power and initiative being exercised by institutions which do not represent the public interest in a democratic sense. For example, a major part of the governmental powers of policy formation and implementation are exercised by the public service, part of the government's law-making functions are delegated to administrative agencies and there is a tendency towards "corporatism... that is, the delegation of public policy formulation to officially recognised interest groups."[84] Delegation to agencies is a necessary part of protecting the public interest by ensuring the government's effective operation or supplementing gaps in the political process. Less obvious examples of delegation exist in the substantive law. For example, the government has effectively delegated to private entities the right to levy costs on society by providing business with such incentives as limited liability and bankruptcy laws. Tort law provides another example of this form of wealth redistribution. Costs registered in the market place are not given by nature but are channelled by legal rules, rights and definitions.

D. THE PRIVATE SPHERE

(i) The inviolate nature of private property

The question of legitimacy also arises in the private sphere in the form of arguments postulating a presumption in favour of the status quo because it is the result of voluntary arrangements involving private property. Thus it is argued that shareholders contribute the capital of the company, own the residual claim,

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82 D Engle suggests note 2 *supra* at 33, that if one can identify (1) legislative sanction of the goal of CSR, and (2) legislative assistance to each corporation's management in picking out the types of corporate actions or ommissions justified by pursuit of the goal then voluntary pursuit of the goal in question would seem to be a socially desirable instance of corporate altruism.

83 Note 80 *supra*; D Sturm "Corporations, Constitutions and Covenants" (1973) 41 *J Am Academy of Religion* 331 at 353.

84 R Mulgan *Democracy and Power in New Zealand* (1984) p 99.

and may have different visions of the social good. When it becomes a matter of selecting preferences managers have no comparative advantage.[85] It is also argued that managers' obligations to consider shareholders' economic interests are grounded in the shareholders' "warranted expectations by tradition and the default of any other champion uniquely appropriate to represent their private property interests".[86] Williamson[87] expands on this theme. He argues that, of all the constituencies affected by the company, shareholders most need their interests represented by management. Shareholders face "diffuse but significant risks of appropriation because the assets in question are numerous and ill defined and cannot be protected in a well-focused transaction-specific way". In addition shareholders face special problems in negotiating safeguards because they are "diffused, disorganised, reliant on information supplied by those in control and may lack the expertise to protect themselves." Other constituents, in contrast, do not have the same initial capital investment and may go elsewhere. An important part of shareholder protection is the profit maximising orientation because it, supplemented by accountability mechanisms, aligns management discretion with the objectives of the shareholders in making the initial capital investment. A final argument along these lines is that CSR prevents shareholders from engaging in socially responsible behaviour with their share of the company profits.[88]

Counter-arguments do exist. For example, it can be argued that only those who are shareholders prior to the introduction of CSR will suffer, to any extent, from a defeat of warranted expectations. Subsequent shareholders can expect the price they pay for shares to reflect the increased risk or potential liability borne by the company. Even in respect of prior shareholders, the "warranted expectations" argument[89], without more, is not strong. Every legislative imposition of liability must, to a certain extent, defeat expectations that the status quo will continue.[90] Furthemore acceptance of Williamson's argument depends on empirical observations as to how well the status quo, in the form of governmental regulation, protects the interests of other constituencies affected by corporate operations. Thus, his conclusion that the wider community interest in environmental protection does not require protection by the alteration of managerial behaviour is based on the high cost that would be involved if the corporation is politicised or deflected from its chief purpose of serving as an economic instrument. This does not address the costs levied on society as a result of an individualistic and short-term profit orientation on the part of the

85 R Posner note 56 *supra* p 313.

86 C Stone note 2 *supra* at 566.

87 Note 6 *supra* at 1210-15.

88 On the basis that CSR leads to less profits for shareholders. M Friedman note 69 *supra*.

89 This argument becomes most dubious in those industries which involve appropriation of the community's durable infrastructure. In these cases it is difficult to see the basis on which private interests claim to be privileged.

90 As Justice Heher points out in *Berger v United States Steel Corporation* 70 A 2d 164 (1950), "... the contractual rights of the stockholders... are not proof against alteration required by the public interest."

corporate business community in the event of regulatory failure. His description of the shareholders as being particularly unprotected could potentially be transcribed to other constituencies such as the public and the workers. For example, the public interest in the environment could be described as an interest in assets which are "numerous and ill-defined and cannot be protected in a well-focused transaction-specific way".[91] Similarly the public could be described as a constituency that is "diffused, disorganised, reliant on information supplied [by the company] and... lack[ing] the expertise to protect... [itself]".[92] It is also the case that Williamson's portrayal of the shareholders as being particularly vulnerable in relation to the company may have to be rethought after indications that there has been a shift from individual to institutional equity investors.[93] The last objection to CSR lacks any weight in most projects suggested as appropriate for CSR because the expenditures in question cannot be adequately instigated by the shareholders out of individual shares of profit. In addition, if the focus is on a form of CSR aimed at preventing the harmful externalities of corporate operations remedial measures may not be economically appropriate or physically possible.

(ii) The company as an appropriate mechanism for CSR

Objections to the notion of the firm as an appropriate forum for political decisions have already been canvassed. There are some remaining elaborations on this theme. The first depends on a conceptualisation of the firm as a nexus of converging contracts between and among workers, investors and consumers. Both Mashaw[94] and Fischel[95] argue from this that the company is a legal fiction, as incapable of having moral or social responsibilities as any other inanimate object.[96] This argument has weaknesses. While the notion of the company itself is a legal invention, it is clearly as capable of acting through its human agents here as it is in other areas.

Another argument, developed by Mundheim[97], is that in the private sphere better mechanisms exist for the pursuit of non profit maximising activities than that of the private corporation. He argues that foundations possess several advantages in this field:

> First, the management of such entities is chosen because of its "familiarity with the social problems to which the foundation addresses itself.[98]

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91 Note 6 *supra* at 1210.

92 *Id.*

93 P Redmond note 1 *supra* pp 89-90; A Conard "Beyond Managerialism: Investor Capitalism" (1988) 22 *University of Michigan Journal of Law Reform* 1.

94 Note 41 *supra* at 126.

95 Note 36 *supra* at 1273.

96 For an introduction to the corporate moral agency debate see J Nesteruk "Bellotti and the Question of Corporate Moral Agency" (1988) *Col Bus L Rev* 683.

97 Note 36 *supra* at 1256-1258.

98 *Ibid* at 1258.

> Secondly, the foundation is staffed by persons whose professional qualifications give them special expertise in carrying out the principal functions of the institution.
>
> Thirdly, "the work of the foundation is subject to public scrutiny and discipline because information about its aims and activities is publicly available".[99] In contrast a corporation is judged on its "financial results" and the costs of CSR are "buried in its profit and loss statement".

Nevertheless, while it is true that better structures for the pursuit of non-profit-maximising goals may exist in the private sphere they are not a realistic alternative when the issue involves minimising the undesirable side effects of corporate activities.

E. LIMITATIONS ON THE IMPLEMENTATION OF CSR

While there may be some basis for rejecting the arguments that CSR is unworkable, in respect of all except the broadest interpretations of what it is that the concept means, such arguments do indicate, on a very abstract level, the kinds of limitations which it may be appropriate to impose on the use of CSR in order to ensure that it is operable and justifiable in practice. The following factors can be deduced from the foregoing debate as appropriate parameters in using CSR as a law reform strategy:

- The concept is implemented by legislation and incentives, standards and accountability mechanisms are tailored to meet specified governmental objectives.
- The nature of the social problem to be addressed by the use of the concept is such that the public interest in dealing with it is sufficiently strong to outweigh the possible risk of loss in private efficiency.
- The concept is designed primarily to deal with negative externalities caused by corporate business operations.
- The concept is used in those situations where companies are likely to have superior knowledge about risky activities, including "the benefits of activities, the costs of reducing risks or the probability or severity of the risks"[100], and is used either to disseminate that information or to ensure that it is acted upon effectively.
- The concept is limited to deal with those problems which are foreseeable by the corporation on a responsible assessment of the facts.
- The concept is used in situations which are oriented towards factual assessment, in other words, where it is not desirable to impose a flat prohibition on the conduct which may cause the harm.
- The concept is used to address problems that may result in irreparable harm and which are not easy to compensate financially.

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99 *Id.*

100 S Shavell note 15 *supra* at 359.

- Shareholders cannot individually rectify the problem towards which the concept is tailored out of their share of corporate profits.
- The concept is implemented in such a fashion as to avoid, to the greatest extent possible, disturbance of the market equilibrium, and the company's sensitivity to that equilibrium.

IV. CONCLUSION

The concept of CSR is capable of many interpretations. While all involve some degree of reliance on the corporate sector to address social problems it is clear that some will raise greater dilemmas in theory and practice than others. From this it becomes obvious that many of the most difficult and challenging issues raised by the debate on CSR cannot be addressed on the abstract and preliminary level at which the arguments canvassed in this paper have been conducted. It is possible that the apparent reluctance to take up the issue of CSR in Australia, as it has been explored in the American literature, indicates an understanding of the need to address the concept in its specific manifestations and in particular areas of reform. In 1989 the Senate Standing Committee on Legal and Constitutional Affairs[101] explicitly referred to the American debate in a manner which seems to support this suggestion. It looked at the issue of whether company directors should be legally obliged to take into account the interests of consumers and the environment when making business decisions on behalf of the company and concluded that such interests should be dealt with in legislation aimed specifically at those matters.[102] In the environmental area, by way of example, there have, in fact, been legal reforms designed to shift some of the responsibility for monitoring, and taking measures to minimise, the risk of environmental harm onto the organisations whose activities create the potential for such harm.[103] There have also been numerous

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101 Note 1 *supra*.

102 It reasoned, *ibid* at [6.25]-[6.56], that requiring directors to take into account a wide range of potentially conflicting interests would weaken their accountability to the shareholders, raise the already onerous nature of directors duties to an unacceptable level and add little to current commercial practice. Nevertheless it did conclude that employees and creditors share a "special relationship" with the company and made specific recommendations in relation to those interests. In relation to employees the Committee recommended, *ibid* at [6.4]-[6.24], that it be made clear that employees interests might be taken into account by directors when making management decisions. Because creditors already had statutory rights under ss 556-557 of the *Companies Code* (now ss 592-593 of the *Corporations Law*) the Committee confined itself to recommending, *ibid* at [5.47], that all creditors be given permission to "share equally in sums recovered from directors".

103 See, for example, the *Environmental Offences and Penalties Act* 1989 (NSW) as amended by the *Environmental Offences and Penalties Amendment Act* 1990 (NSW). Sections 5, 6 and 6A of the Act create broad, factual-orientated offences for the wilful or negligent disposal of waste, the leakage and spillage, or the emission of controlled substances into the atmosphere, "in a manner which harms or is likely to harm the environment." Under s 10 officers of a company can be made liable unless they had no actual, imputed or constructive knowledge of the company's contravention, were in no position to

suggestions for developing an environmentally aware corporate culture. In other words, one with ethical goals that go beyond strict compliance with legal requirements.[104]

Many factors suggest the continuing relevance of the CSR debate in Australia. These include, moves towards privatisation, growing public concern about the negative externalities of corporate operations, the weakening of the welfare state, continued law reform scrutiny of the companies legislation, an increasing academic interest in corporate self regulation[105], and a judical trend towards interpreting the company's interests to mean not just the interests of members but also such constituents as the creditors in situations of insolvency.[106]

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influence the conduct of the corporation, or used all due diligence to prevent the contravention. The aim is to encourage the adoption by companies of pollution compliance programs (including regular environmental audits). See P Ibbotson "Environmental Compliance Programmes and Dealing with the Practical and Legal Issues of Environmental Audits" *The 3rd Annual Pollution Law Conference* (October 1991).

104 Using such techniques as vision statements, ongoing compliance programs, policies of openness and disclosure within the company and to the public, audit regimes and data baselines. See R Schaffer note 1 *supra*. Johnson & Johnson Australia is one example of a company which has adopted the policy of publicly displaying performance statistics and their success at completing, achieving and maintaining an environmentally responsible star-rating system that is subject to annual review.

105 Note 5 *supra*.

106 Note 17 *supra*.