

Corporate Culture and Liability

Global Corporate Governance
Colloquia (GCGC)

House of Finance, Goethe University
Frankfurt, 7 June 2019

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Larry Fink's Statement about the Role of the Corporation

Corporations 'must benefit all their stakeholders, including **shareholders**, **employees**, **customers**, and the **communities** in which they operate'.

BlackRock, Larry Fink's Annual Letter to CEOs, *A Sense of Purpose*, Jan. 12, 2018.

Presentation Roadmap

1. To what extent has 'corporate culture' become part of the regulatory dialect and why is it important?
2. What does 'corporate culture' mean?
3. Some recent corporate scandals that exemplify a flawed corporate culture.
4. Who should the law target for wrongdoing attributable to a flawed corporate culture?

Everybody's Talking about 'Corporate Culture' (even though it's a 'slippery' and 'elusive' concept)

- Basel Committee on Banking Supervision Guidelines (2015)
- Federal Reserve Bank of New York (2019)
- FRC, *Corporate Culture and the Role of Boards* (2016)
- 2018 UK Corporate Governance Code
- British Academy, *Future of the Corporation Research Program* (2017-2020)
- 4th edition ASX Corporate Governance Principles (2019)
- APRA, *Inquiry into the Commonwealth Bank of Australia* (2018)
- Australian Banking Royal Commission Final Report (February 2019)

What is Corporate Culture?

- ‘a multi-layered, scalar, social phenomenon, concerned with values and related to actions’ (*Future of the Corporation* project, 2018).
- ‘shared values and norms that shape behaviours and mindsets’ (Banking Royal Commission, 2019)
- the ‘collective corporate conscience’ (Bradshaw, 2013)
- the ‘organisation’s DNA’ (Longstaff, 2016; Bonchek, 2016)
- the ‘mindset of firms’ (ASIC, *Corporate Plan 2016-17 to 2019-2020*)
- ‘the way things are done around here’ (APRA Report, 2018)

The Wells Fargo (WF) Banking Scandal

- Aggressive growth strategy.
- Wells Fargo employees were 'squeezed...to the breaking point' (Senator Elizabeth Warren).
- A few bad apples or 'rotting barrels' (Silbey, 2009)?
- 'That's not who Wells Fargo is'.



O Tempora, O Mores! (Cicero)

- **VW emissions fraud** – illegal emissions defeating software
- **21st Century Fox** and **CBS News** – Sexual harassment claims
- **BP** – 2010 Deepwater Horizon Oil Spill, Gulf of Mexico
- **PG&E** – 2017-18 Californian wildfires
- **Commonwealth Bank of Australia** – 2017 money-laundering/terrorism scandal - financial success 'dulled the senses' of the CBA
- **Australian Banking Royal Commission** – 2019 Final Report findings.

Who Should the Law Target for Widespread Wrongdoing from Flawed Corporate Culture?

- The **corporation** (entity liability)?; OR
- The **individuals** (often **low-level employees**) who committed the wrongful acts?; OR
- **Senior managers** and **directors**?

le ‘**Why isn’t Wall Street in jail?**’, Matt Taibbi (2011); Senator Elizabeth Warren (2016); ‘the responsibility gap’ (Sam Buell, 2018) OR

- **Directors** and **officers**, via civil law, for breach of duty of oversight/ care and diligence?

The Ambiguous Role of the Independent Director

Independent directors could be described as monitoring:-

- integrity;
- efficiency/performance; or
- social responsibility.

Brudney, 'The Independent Director – Heavenly City or Potemkin Village' (1982) 95 *Harv. L. Rev.* 597



Directors' Duty of Oversight under US Corporate Law

Graham v Allis Chalmers Manufacturing Co (Del. S.C. 1963) – Directors need not be the FBI.

In re Caremark International Inc. Derivative Litigation (Del. Ch. 1996). Caremark standard of 'bad faith'/'utter failure'/intentional dereliction of duty approved in:-

- *In re Walt Disney Co. Deriv. Litig.* (Del. S.C. 2006)
- *Stone v Ritter* (Del. S.C. 2006)
- *In re Citigroup Inc. Shareholder Derivative Litigation* (Del. Ch. 2009)
- *Reiter v Fairbank* (Del. Ch. 2016)
- *City of Birmingham Retirement and Relief System v Good* (Del. S.C. 2017)

Overall Message to US Directors

- The duty of oversight is aspirational only – you have nothing to fear.
- Is this desirable from a policy perspective? (Spamann, ‘Monetary Liability for Breach of the Duty of Care?’ (2016) 8 *J Legal Analysis* 337).

A Potential Trip Wire for US Directors

Strine CJ's dissent – Directors not protected because company's strategy 'purposely skirted, and and in many ways consciously violated, important environmental laws'.

City of Birmingham Retirement and Relief System v Good (Del. S.C. 2017)



Directors' Duty of Oversight under UK Law

- *In re City Equitable Fire Insurance Co* (1925)
- 1990s – heightened objective standard introduced in *Norman v Theodore Goddard* (1992) and *Re D'Jan of London Ltd* (1993)
- *Secretary of State for Trade and Industry v Baker (No. 5)* (1999) (directors must monitor from both a competence and an integrity perspective)
- But procedural restrictions = 'accountability firewall' (Loughrey, 2014)

Potential Director Liability for Monitoring Failure re Flawed Corporate Culture in Australia

- Directors' statutory duties = public duties + public enforcement model.
- Directors' actions may affect 'the community, not just the shareholders, employees and creditors' (*ASIC v Healey* (2011)).
- Potential omissions liability (*ASIC v Adler* (2002)).
- Potential ESG liability (Hutley SC and Hartford-David, 2019).
- Potential 'stepping stone' liability (*ASIC v Cassimatis (No 8)* (2016)).
- Limited BJR + prohibition on exculpation clauses or shareholder waiver.
- ASIC's new mantra - 'Why Not Litigate?'.