Global Corporate Governance Colloquia 2019

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House of Finance

Goethe University Frankfurt

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Protocol – Session 1
Corporate Culture & Liability

Speaker: Jennifer Hill
Discussant: Edward Rock

Jennifer Hill was, at the time of this presentation, Professor of Corporate Law at The University of Sydney Law School. She has subsequently been appointed the Inaugural Bob Baxt Professor of Corporate and Commercial Law at Monash University Faculty of Law in Melbourne Australia and is Professor Emeritus at the University of Sydney. Jennifer writes in the area of comparative corporate governance and has held visiting teaching and research positions at several international law schools including Cambridge University; Cornell University; Duke University; NYU Law School; University of Virginia and Vanderbilt University. Jennifer currently sits on ECGI's Research Committee and chairs the Research Member Engagement Committee. She is a Fellow of the Australian Academy of Law (AAL) and a member of the External Advisory Panel of Australia's business conduct regulator, the Australian Securities and Investments Commission (ASIC).

Edward Rock's main areas of teaching and research are corporate law and corporate governance. In his 50 or so articles, he has written about poison pills, politics and corporate law, hedge funds, corporate voting, proxy access, corporate federalism and mergers and acquisitions, among other things. In addition to teaching and research, Rock is the director of NYU's Institute for Corporate Governance & Finance.

Protocol of Session 1, Friday 7 June (10.00 a.m. – 11.00 a.m.)

In the second part of this session, Jennifer Hill presents a paper on "Corporate Culture and Liability". Her presentation addresses four distinct issues: 1. To what extent has "corporate culture" become part of the current regulatory dialect and why is it important? 2. What does corporate culture mean?; 3. Recent corporate scandals that exemplify flawed corporate cultures; 4. Who should the law target for wrongdoing attributable to flawed corporate culture?

As the presenter notes, even though "corporate culture" has been described as a slippery concept, it is now a central regulatory focus around the world (e.g., Basel Committee on Banking Supervision; Federal Reserve Bank of New York; UK Financial Reporting Council (FRC); 2018 UK Corporate Governance Code; British Academy' *Future of the Corporation Research Program*; Australian Banking Royal Commission Final Report).

In spite of widespread regulatory interest, there are numerous different definitions of the concept. These include the idea that corporate culture is "a multi-layered, scalar, social phenomenon, concerned with values and related to actions" (British Academy' *Future of the Corporation Research Program*, 2018); "shared values and norms that shape behaviours and mindsets" (Australian Banking Royal Commission, 2019); the "collective corporate conscience" (Bradshaw, 2013); the "organisation's DNA" (Longstaff, 2016; Bonchek, 2016); the "mindset of firms" (Australian Securities and Investments Commission (ASIC); "the way things are done around here" (Australian Prudential Regulation Authority (APRA) Inquiry into the Commonwealth Bank of Australia, 2018).

Rationales for why a healthy corporate culture matters also differ significantly. They include arguments that corporate culture is a vital component of risk management, compliance, business implementation and strategy, or economic success. Some of these rationales focus on performance, whereas others have an accountability basis.

In her discussion of corporate scandals involving flawed corporate culture, the presenter pays particular attention to the Wells Fargo banking scandal. Wells Fargo was notable for its aggressive growth strategy, which, according to Senator Elizabeth Warren, resulted in its employees being "squeezed to the breaking point". Although Wells Fargo argued that misconduct at the bank was attributable to "a few bad apples", nonetheless, the extensive scope of the frauds suggests that this was more a matter of "rotting barrels" (Silbey, 2009) or, in other words, defective corporate culture.

Wells Fargo is by no means an isolated example of a flawed corporate culture. Other scandals, sharing some of its features discussed in the paper, include: the VW emission fraud; sexual harassment claims at 21st Century Fox and CBS News; the BP Deepwater Horizon Oil Spill; the PG&E Californian wildfires; and recent misconduct at a number of Australian banks. These various scandals demonstrate that defective corporate culture can inflict serious damage on stakeholders (such as employees, customers and shareholders), communities, and society as a whole.

Finally, the paper explores whom the law should target for wrongdoing that arises from flawed corporate culture – the corporation itself; the individuals that committed the wrongful acts (often low-level employees); or senior managers and directors. The presenter examines two specific

types of liability – (i) entity criminal liability and (ii) personal liability of directors and officers for breach of the duty of oversight. Adopting a comparative analysis, the presenter discusses the scope and effectiveness of these forms of liability in three jurisdictions – the US, the UK, and Australia.

In the second part of this session, the discussant, Edward Rock, starts by pointing out that the Wells Fargo repayment to the customers was relatively low ($142 million settlement). The question of these scandals is which parts of the law should be affected. According to the discussant, corporate and criminal law have fundamentally different approaches: corporate law sets limits with respect to the accountability of managers. It recognizes that excessively high liability risks could make directors and officers risk-averse. This would not be of interests of shareholders, who are already protected by limited liability. The goal of criminal law, on the other hand, is quite different. Its aim is to implement criminal punishment and shareholders' interests are irrelevant to this goal. Therefore, it is questionable whether corporate law and criminal law can be considered as pursuing the same objectives. According to the discussant, the most interesting part of paper lies in its comparative analysis, particularly Australian developments concerning the introduction of provisions under the Model Criminal Code, which provide entity liability for defective corporate culture, but which have been rarely applied in practice.

The presenter then responds to the comments of the discussant. Regarding the different goals of corporate law and criminal law, she notes that, unlike in the US, in the UK and Australia, officers and directors cannot be exculpated from their duty of care by the corporate constitution. Therefore, the different goals between corporate and criminal law are not as clear-cut in these two jurisdictions as it may be in the US. The last 20 minutes of the session comprise an open discussion of the paper with all participants. Issues covered in the open discussion include: i) tension between corporate culture and different business models; ii) the difficulty of measuring and targeting organizational culture, given its complexity; iii) The impact of the Volcker Rule on corporate culture; iv) the close connection between culture and incentives; v) the operationalization of culture as a mechanism to hold directors liable; vi) the implications of corporate culture for a shareholder value model of the firm.