Corporate Culture and Corporate Governance

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Everybody’s Talking about ‘Corporate Culture’ (even though it’s a ‘slippery concept’ (Awrey et al, 2013))

- Federal Reserve Bank of NY (Thomas C. Baxter) (2016)
- FRC, Corporate Culture and the Role of Boards (2016)
- 2018 UK Corporate Governance Code
- British Academy, Future of the Corporation Research Program (2017-2020)
- Proposed 4th edition ASX Corporate Governance Principles
- Securities and Exchange Board of India (SEBI), Board Evaluation Guidelines (5 January 2017)
What is Corporate Culture?

Corporate culture is:

• ‘a shared set of values or assumptions’ (ASIC Commissioner John Price, 2015);

• the ‘mindset of firms’ (ASIC, Corporate Plan 2016-17 to 2019-20)

• the ‘organisation’s DNA’ (Longstaff (2016); Bonchek (2016)).
The Wells Fargo (WF) Banking Scandal

• Aggressive growth strategy.

• Wells Fargo employees were ‘squeezed...to the breaking point’ (Senator Elizabeth Warren).

• Did WF have a ‘corporate culture’ problem or just ‘a few bad apples’?

• Bad apples vs ‘rotting barrels’ (Silbey, 2009).
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

• **Commonwealth Bank of Australia** – 2017 intelligent deposit machine money-laundering scandal – dulled ‘organisational senses’ - $8.9 billion deposited in cash.

• **Australian Banking Royal Commission** – Interim Report 2018
Who Should the Law Target and Hold Accountable for Widespread Wrongdoing from Flawed Corporate Culture?

• The corporation (eg under entity criminal liability)?; OR

• The individuals (often low-level employees) who committed the wrongful acts?; OR

• Senior managers and directors who created the corporate culture that provided the incentives for the wrongdoing via criminal law?

Ie ‘Why isn’t Wall Street in jail’?, Matt Taibbi (2011); Senator Elizabeth Warren (2016); OR

• Directors and officers, via civil law, for breach of duty of oversight/care and diligence?
Independent directors could be described as monitoring:-

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

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:-

- Stone v Ritter (Del. S.C. 2006)
- In re Citigroup Inc. Shareholder Derivative Litigation (Del. Ch. 2009)
- Reiter v Fairbank (Del. Ch. 2016)
Two Possible Trip Wires Emerge for Directors

City of Birmingham Retirement and Relief System v Good (Del SC 2017)

Strine CJ’s dissent – Directors not protected because company’s strategy ‘purposely skirted, and...consciously violated, important environmental laws’.

Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund (US S.C., 2015) (potential liability for corporate misstatements under federal law)
Directors’ Duty to Monitor under UK Law

- *In re City Equitable Fire Insurance Co* (1925)


- *Secretary of State for Trade and Industry v Baker (No. 5)* (1999) (directors must monitor from both a competence and an integrity perspective)

- But dearth of case law in the UK – Why?

- Effect of SMCR (Senior Managers & Certification Regime)?

- 2018 UK Corporate Governance Code.
The Role of Directors in Australia

‘[a] director is an essential component of corporate governance...The role of a director is significant as their actions may affect the community, not just the shareholders, employees and creditors’.

*ASIC v Healey* (2011), Middleton J.

Directors have compliance responsibilities to ensure that a company has ‘a proper system of controls and audit’ and that companies act ‘in accordance with their authorised practices’.

(*ASIC v Adler* (2002), Santow J.)
Potential Liability of Directors for Monitoring Failure re CSR and Integrity

• **CSR** – 2016 Memorandum of Opinion re climate change risks (Hutley, SC and Hartford-David)

• **Organizational Integrity** – Reputational damage can constitute harm to the interests of the company for the purposes of stepping stone liability (*ASIC v Cassimatis (No 8)* (2016), [481]-[483]) (per Edelman J).

Seriously flawed corporate cultures can result in massive reputational damage!

• Impact of Australian Banking Royal Commission, Interim Report, September 2018?