Australian Class Actions as a Potential Motivator for Environmental, Social and Governance (ESG) Reporting

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Within an Australian context, in the face of the apparent failure of the government and its agencies to effectively regulate the Environmental, Social and Governance (ESG) behaviour of corporations, deterrence through class action civil litigation is proposed as a methodology which may have significant impact on corporate behaviours in relation to Australian ESG reporting. Deterrence theory and the related concept of avoidance are proposed as motivations to explain the rise in the number of ESG reports being prepared by corporations in Australia.

Field of Interest: Accounting, Corporate governance and accountability

1. Introduction

The Social and Environmental Accounting (SEA) literature provides a range of views and arguments on and around the importance of corporations adhering to the environmental, social and governance (ESG) expectations of the communities within which they operate. Much of the focus of the SEA literature has been on identifying the motivations of organisations engaged in ESG reporting and on estimating the putative information value of such reports to stakeholders. There has been a number of papers which have reviewed and critiqued the progress and achievements of SEA, some of which reveal a level of dissatisfaction and frustration with the progress being achieved, and the direction being taken, by the social accounting project.

Reflecting the burgeoning SEA literature an increasing number of international firms have been voluntarily publishing stand-alone ESG reports[i] detailing their (non) compliance on environmental and social issues. The 2008 KPMG International Survey on Corporate Responsibility Reporting which surveyed the ESG reporting habits of the world's largest firms found "*an important shift in … direction with CSR reporting becoming the norm instead of the exception within the world's largest companies"* (KPMG 2008, p. 2). KPMG report an increase in companies issuing stand-alone corporate responsibility reports from 52% in 2005 increasing to 79% in 2008 (2008, p.14). There is no apparent agreement as to the motivation(s) of the firms who are producing such reports.

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This jump in the level of ESG reporting would imply a concomitant increase in the level of corporate sustainability performance. Yet despite the significant increases in companies preparing ESG reports, and despite the efforts of the SEA academy, ESG events such as the recent disaster in the Gulf of Mexico are still occurring. Given the continuance and severity of such ESG failures it can be argued that the seemingly ubiquitous occurrence of corporate governance misbehaviour may be described, at best, as being episodic, and at worst as being systematic (Cox & Thomas 2009a). These breaches of community ESG expectations continue to occur despite the fact that protective regulation is in place in most advanced economies. The recurrence of such corporate ESG failures, and the resultant social and environmental damage that have invariably ensued, make it apparent that public regulation has proven to be largely ineffectual in preventing corporations and their agents from behaving in ways which harm their communities.

Within an Australian context, in the face of the apparent failure of the government and its agencies to effectively regulate the ESG behaviour of corporations, deterrence through civil litigation is proposed as a methodology which may have significant impact on corporate behaviours in relation to Australian ESG issues. Deterrence theory and the related concept of avoidance can also explain the rise in the number of ESG reports being prepared by corporations in Australia. The relatively recent introduction of a class action regime in Australia in 1992 has improved the access to justice for individuals, including shareholders, wronged by large and powerful organisations. The class action regime has provided a mechanism by which the pooling of claimants can result in significant and deterrent civil damages being awarded and is proving to play a significant complementary role to regulation in moderating corporate behaviours (Murphy & Cameron 2006).

2. Social and Environmental Accounting (SEA)

Social accounting has been, and is, growing rapidly and the extant SEA literature encompasses a broad landscape of differing theoretical viewpoints and methodological approaches (Mathews 1997, Parker 2005, Owen 2008). In addition there have been a number of reviews published on the content, direction and themes of the SEA literature (see for example Mathews 1997, 2002; Gray 2002, 2010; Parker 2005; Deegan and Soltys 2007; Ball and Milne 2007; Owen 2008).

Parker (2005, p.844) described the growing SEA literature as being *"voluminous, disparate,* (and) *eclectic"* and, whilst acknowledging the discipline's lack of a common philosophy, argued that the movement may actually draw strength from the use of multiple methodologies and a variety of theoretical frameworks. Given the non-homogenous nature of SEA research and researchers, defining SEA and its boundaries is somewhat problematic (Gray 2002, Deegan & Soltys 2007, Everett 2007, Owen 2008). Gray (2002, p. 692) described the field as being *"primarily concerned with examining and encouraging the emergence of new 'accountings' – accountings which supplant, complement or challenge the more conventional accountings but in a manner which responds to, even (ideally) resonates with, the concerns and occupations of alternative/critical theorising"*. Whilst it is certain that researchers involved in the SEA arena are non-homogenous, it is reasonable to assert that most researchers engaged in SEA share a subjective bias for change. This bias was identified and described by Medawar (1976) in his seminal paper 'The

social audit: A political view' as the motivation that underpinned his work. It can be argued that most, if not all SEA researchers, are similarly motivated to engage in social accounting by a *"deep rooted sense of justice, decency, need for change, personal commitment and reasonableness outraged by unreasonableness"* (Gray 2002, p.700).

Owen's review of the SEA research published by the Accounting, Auditing and Accountability Journal, identified a consistent theme in the number of SEA papers which attempted *"to identify, and possibly go on to predict, the driving factors behind managerial disclosure decisions"* (2008 p. 247). This reflects a recurrent theme which can be identified within the broader SEA literature of a number of studies which explore the motivations underpinning corporate ESG reporting. A common approach of these authors has been through the lens of political economy utilising stakeholder and legitimacy theory (Lehman 2001). Hopwood posited that it is likely that voluntary corporate ESG disclosure may be best explained by several discrete motivations and called for further research into the complexity of corporate disclosure decision making and for a *"deeper understandings of the(ir) interactions …with the relevant regulatory authorities"* (2009, p.437-438).

There are many calls for a greater level of engagement by SEA researchers and new inter and trans disciplinary approaches (Gray 2010). Responding to prior calls for greater pragmatic engagement between the SEA academy and practice Boyce (2000) suggested that any attempt to involve social and environmental aspects in corporate reporting must necessarily involve accountants but also involve accountants in non-traditional domains. The challenge remains for SEA academics and practitioners to better engage with these non-traditional domains and processes in order to 'harden up' ESG reporting and make the findings more universally usable, reliable, and where possible, quantifiable. Cho, Roberts and Patten drawing on the environmental disclosure and impression management literature argue that corporations prefer the current 'narrative' style of environmental and social disclosure rather than quantifiable information because mediated textual narratives such as those currently produced *"can be deliberately tailored to manage public impressions"* (2010 p.431).

Gray described SEA as a discipline predicated on engagement with practice, *"which 'gets its hands dirty' and is, consequently, partially mired in the impurities of pragmatism"* (2002, p.688). Consequently there is an ongoing tension within SEA brought about by the contradiction inherent in the various calls for SEA to have greater engagement with practice, and the inevitable impact of managerialism, whilst at the same time exhibit the theoretical purity of the critical paradigm[ii]. It may be argued that a 'critical' approach is adopted by most (if not all) social accountants who engage in the SEA project, subjectively (and unashamedly) seeking changes to social and environmental outcomes. Regardless, the tension within the SEA academy between idealism on the one hand and realism, pragmatism and compromise on the other is very real (Ball & Milne 2007). It is argued by both Owen (2008) and Gray (2002) that, to move forward, SEA must be positioned between the radical and managerial approaches. However, in doing so, Owen (2008, p. 241) acknowledges the troubled relationship between what he terms 'mainstream' social and environmental accounting and critical accounting research.

A further theme which resonates clearly from the reflective reviews of the SEA literature is a level of angst and dissatisfaction with the progress and impact being made by social accounting (Ball & Milne 2007). To sense the frustration one only needs to look at the titles of some of those review articles, such as Owen's (2008) 'Chronicles of wasted time' and Ball and Milne's (2007) 'Talking to Ourselves? The intellectual and activist failure of social accountants and what to do about it'. The frustration occurs because SEA researchers and activists are committed to emancipatory change and to improving social and environmental outcomes and are disappointed with the slow pace of change being achieved.

3. Deterrence as a Motivation For ESG Disclosure

Reviews of the SEA literature have highlighted the number of papers which have attempted to identify the motivations of firms preparing ESG reports and bemoaned the slow rate of identifiable change in corporate ESG behaviour (Ball & Milne 2007). Murray, Sinclair, Power and Gray (2006, p.229) identify the potential role that financial markets can play in encouraging organisations to behave in a more socially and environmentally sustainable manner. However, Murray *et al* (2006) and Hopwood (2009) also identify the apparent absence of will by regulators to closely and effectively control financial markets in order to enforce the adoption of ESG practices by firms. Murray *et al* argue that in the failure of regulation "*it must fall to incentive, cajolery and persuasion to encourage markets to act in a manner less incompatible with the social and environmental aims of sustainability"* (Murray *et al*, 2006, p.229). This paper contends that in Australia, deterrence through civil litigation utilising class actions and the continuous disclosure regulatory regime provides a further, and effective, methodology for improving the ESG disclosure and the concomitant sustainability performance of publicly listed corporations.

In explaining the rush by corporations, particularly those in 'sensitive' industries (Brown & Deegan 1998), to produce sustainability reports this paper proposes a corporate motivation different to the variations of stakeholder and legitimacy theory which are dominant in the SEA literature. This paper contends that the recent rise in class action litigation in Australia means that corporations operating in Australia are, to some extent, motivated by the deterrence factor of litigation and produce ESG reports to avoid, or mitigate, such action. General deterrence theory is a widely used criminological theory which has been extended to encompass economic considerations and is regarded as a rational economic choice model (Becker 1968). In utilising deterrence theory this paper assumes a characterisation of regulated corporations and their agents as profit-driven "amoral calculators" (Kagan & Sholz 1984).

Deterrence Theory

Deterrence theory is generally recognised as being first formulated in the works of utilitarian philosophers Cesare Beccaria and Jeremy Bentham (1809 & 1843, both cited in Anderson, Harris & Miller 1983) and holds that crime is deterred by the threat of punishment. The threat of punishment is mediated by the severity of the punishment and the likelihood of the punishment occurring (Anderson, Harris & Miller 1983). 'Specific deterrence' is aimed at the individual who committed the criminal act whilst 'general deterrence' extends the deterrence beyond the individual criminal act

to include individuals who may consider committing similar acts in the future. Both models of deterrence are rational choice models which imply that the decision to commit a crime involves a rational decision process. Becker (1968) used economic theory and fiscal psychology to extend deterrence theory to include the conceptualisation of expected gain in the decision model. Becker's (1968) approach, combining the theory of rational choice with the utility maximising rationale from economics, posed criminal behaviour as a rational economic choice. Situated with the general theory of deterrence is the concept of avoidance. Avoidance is where offenders expend resources on activities to decrease any anticipated punishment by reducing the probability of punishment or limiting the penalty if apprehended (Nussim & Tabbach, 2009).

Whilst this rational economic approach has limitations in describing criminal decisions made in the case of crimes of passion and anger, in which the decision process may be curtailed, that is not necessarily the case with corporate crime. Pearce noted that *"corporate crimes are, above all, organizational crimes"* (1993, p.136). Such crimes *"are the result of deliberate decision making (or culpable negligence) of those who occupy structural positions within the organization as corporate executives or managers. These decisions are organizationally based – made in accordance with the normative goals (primarily corporate profit), standard operating procedures, and cultural norms of the organization – and are intended to benefit the corporation itself"* (Kramer 1984, p.18, cited in Pearce 1993, p.136). Braithwaite and Geis argued that deterrence would be more effective with such white collar crimes as they are not *"crimes of passion; they are not spontaneous or emotional, but calculated risks taken by rational actors. As such, they should be more amenable to control by policies based on the utilitarian assumptions of the deterrence doctrine"* (1982, p.300). It is contended that for these profit-oriented 'amoral calculator' entities only the *"fear of imminent legal penalties that exceed the cost of compliance can induce profit-seeking firms to invest in compliance with regulatory demands"* (Thornton, Gunningham & Kagan 2005, p. 263). It follows that as the perceived risk and cost of ESG transgressions being detected rises, more profit driven entities will increase their investment in compliance and avoidance (Thornton, Gunningham & Kagan 2005). Hopwood (2009) recognised the legitimating impact of corporate voluntary preparation of ESG reports and argued that rather than such reporting enhancing transparency and visibility could result in *"fewer questions might be asked of the legitimated organization and thereby less might be known of it…despite the apparent openness of its reporting*" (2009, p.437). It is our contention that the increase in corporate ESG reporting may be in part explained by general deterrence theory and avoidance.

Class Action Litigation

This paper contends that the relatively recent development in Australia of the class action regime has the potential to have a real impact in improving the environmental, social and governance performance of corporations. Class action litigation has been available in Australia since 1992 with the amendment to Part IVA of the *Federal Court Act*. The number of class action cases appearing in Australian courts has been steadily increasing since that time. The central purpose of the class action regime was to provide a mechanism which allowed access to justice for individuals seeking redress from defendants who typically were both more powerful and with far greater

access to resources (Murphy & Cameron 2006). The regime was designed to enhance the efficiency and fairness of the legal system by allowing the aggregation of claims by wronged individuals, who on their own may not have been able to pursue their claims. The legislation also recognised that in a global economy civil wrongs can be perpetrated on a mass scale by large entities. These corporations generally have an advantage over wronged individuals in any consequent litigation or dispute resolution because of the entities 'deep pockets' and the experience developed by the corporation from a history of litigation (Murphy & Cameron 2006, p.402). The class action legislation was clearly also targeted at re-dressing this power imbalance by creating a power in numbers which would not exist if claims could only be pursued individually (Murphy & Cameron 2006).

The procedures for representative actions are not new, having existed in English rules of court dating from 1883 which provided that *"where there are numerous persons having the same interest in one course or matter, one or more of such persons may sue or be sued…on behalf or for the benefit of all persons so interested"* (Chalmers & Muir Mackenzie 1883, p. 222). These English rules on representative actions were transferred to Australian courts at Federation; however they were narrowly held and fell into disuse until a 1988 report to federal Parliament, prepared by the then Law Reform Commission, recommended the development of a grouped proceedings regime (Murphy & Cameron 2006).

Regulation & Shareholder Activism

In the United States of America, where class actions have been part of the legal 'furniture' for much longer than in Australia, class actions are recognised as being an important and necessary complement to public regulation in controlling the behaviours of corporations (Cox & Thomas 2009b). In developing the class action regime in Australia the Law Reform Commission also recognised the important role that grouped proceedings would play in enforcement by acknowledging that *"enabling people to have increased access to legal remedies in court proceedings could render the substantive law more enforceable and thus encourage a greater degree of compliance with laws the purpose of which is to prevent or discourage activities which cause loss or injury…Respect for the law should be enhanced if access to remedies is facilitated"* (Law Reform Commission 1988, p.33).

Whereas regulatory regimes generally operate to penalise corporate misbehaviour they do not usually work to compensate shareholders for losses resulting from breaches of the law by corporations and their officers (Murphy & Cameron 2006, p.244). The regulatory role played by grouped proceedings litigation in Australia is perhaps best evidenced in the recent rise in the number of shareholder class actions. It can be argued that class actions, which have been described as 'private regulation' or 'private enforcement', operate to complement existing corporate and consumer legislation (Murphy 2009, Murphy & Cameron 2006). This role has been accepted by both of the key Australian corporate regulatory bodies, the Australian Securities and Investment Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC). Mr Jeremy Cooper, the then Deputy Chair of ASIC, stated in December 2005 that shareholder class actions had a useful role to play in "*maintaining the integrity of the equity capital market*" and commented that *"ASIC cautiously welcomes the emergence of the shareholder class action in Australia as*

a "self help" mechanism whereby shareholders are able to seek damages for loss incurred at the hands of directors and advisers who negligently or dishonestly cause loss to those shareholders" (Cooper 2005). Similarly, ACCC Chairman Graeme Samuel welcomed the settlement of the Vitamins Cartel class action and the deterrence value of the $30.5 million award which was "*a lesson to those that are involved in cartels*" (Samuel 2006).

Contrasting Regulatory and Civil Penalty Regimes

Most shareholder class actions in Australia have arisen out of breaches of the Australian corporate continuous disclosure regime. This regime was introduced in 1994 due to the perceived failure of market forces to guarantee adequate and timely disclosure of price sensitive information and, amongst other things, to minimise the opportunities for insider trading (Murphy 2009). In 2004 the corporate regulator, ASIC, was given some teeth when it was granted the power to impose administrative infringement penalties. This corrected an identified failing in the regulator's capacity to enforce the intent of the continuous disclosure law. This shortcoming had been made evident in 2002 when ASIC had refused to proceed against Western Mining for an alleged breach of its continuous disclosure obligations despite considering that it had an arguable case (Murphy 2009).

The level of corporate wrongdoing in Australia seems undiminished despite the corporate watchdog having greater powers than at any previous time in Australia's history. The comparison between regulatory and civil penalty regimes is perhaps best illustrated in the following tables which detail some of the enforcement results achieved in Australia by ASIC contrasted with the results achieved using civil class actions (not instigated by regulatory bodies).

Table 1: Outcomes of Regulator Action (Source: Murphy, 2010)

Enforcement activities	Breach date	Commencedate	Resolved	Result
Crown Casino Ltd – enforceable undertaking	1998	1998	1998	Undertaking to improve compliance
Harts Australasia Ltd – prosecution of offence (two directors)	2001	2006	unknown	
Southcorp Ltd – civil penalty	2002	2002	2003	$100,000 fine
Chemeq Ltd– civil penalty	2003	2004	2006	$100,000 fine
Chemeq Ltd – civil penalty	2004	2004	2006	$350,000 fine
Fortescue Metals Group Ltd – civil penalty	2004	2006	pending	Appeal result pending
Solbec Pharmaceuticals Ltd – infringement notice	2004	2004	2005	$33,000
QR Sciences Holding Ltd – infringement notice	2005	2006	2006	$33,000
SDI Ltd – infringement notice	2005	2006	2006	$33,000
Avastra Ltd– infringement notice	2005	2006	2006	$33,000
Astron Ltd – infringement notice	2006	2006	2006	$66,000
Multiplex Group Ltd – enforceable undertakings	2005	2006	2006	Undertaking to improve compliance, $32M compensation fund, and early payment of $50M by company founder
James Hardie Group – civil penalty (company and officers)	2001	2007	2009	Lost
Nufarm- civil penalty	2010	2010	2010	$66,000 civil penalty. Enforceable undertakings.

Table 2: Outcomes of Civil Class Actions (Source: Murphy, 2010)

Shareholder class actions	Breach date	Commencedate	Resolved	Result
GIO Australia Ltd – class action	1998	1999	2003	$112M settlement
Concept Sports Ltd - class action	2004	2004	2006	$5M settlement
Aristocrat Leisure Ltd -class action	2002-3	2003	2007	$145M settlement
Telstra - class action	2005	2005	2007	$5M settlement
Ion Ltd – claims in liquidation	2003-4	2006	2008	Confidential
Village Life Ltd- class action	2003-5	2006	2009	< $5M settlement
Sons of Gwalia Ltd – claims in liquidation	2000-4	2005	2007	More than $50 million
MediaWorld Communications Ltd -class action	2000-4	2005	2010	Settled for little- defendants insolvent
Multiplex Group Ltd - class action	2004-5	2006	2010	$110 million
Australian Wheat Board Ltd - class action	2002-6	2007	2010	$39.5 million
Downer EDI Ltd – class action	2006	2007	2008	Confidential
Evans and Tate Ltd - class action	2004-5	2007	pending	Withdrawn -company in liquidation
Centro Property Group - class action	2007	2008	Pending	
Credit Corp Group – class action	2007-8	2008	pending	
Oz Minerals – class action	2008	2009	pending	
Nab – class action	2010	2008	pending	

Corporate regulators such as ASIC may be viewed as *"civic minded policymakers that seek to deter wrongdoing through a judicious mix of criminal, monetary and reputational penalties"* (Cox & Thomas 2009, p.166) who work hard to stem an unstoppable tide of corporate misconduct. However regulators such as ASIC are often described by commentators as being *"comprised of bumbling bureaucrats, who are poorly informed about market conditions, under-incentivized to bring needed enforcement actions, and 'captured' by the firms that they claim to regulate"* (Cox & Thomas 2009, p.166). The newspapers are full of criticism whenever a high profile case by ASIC fails, or when ASIC does not follow up a particular episode of misconduct in time or at all. The debate about whether corporate regulators are as effective as necessary in dealing with corporate misconduct is ongoing, however the Australian examples presented above are evidence of the need for ancillary private regulation.

The monetary penalties achieved by the regulator are significantly lower than those achieved under the class action regime. Penalties achieved by the regulator can be measured in the hundreds of thousands of dollars whereas penalties under the class action regime are more usefully measured in the millions. As an example, in the Multiplex case which involved misleading corporate statements relating to the company's construction of the Wembley stadium in England, the regulator acted before any private suit. As a consequence of the regulators action penalties including undertakings to improve compliance and a A$32 million compensation fund for Multiplex investors were awarded. In contrast, the class action, which was run after the regulators action was completed, resulted in a settlement for an additional A$110 million for investors, more than three times as large as the compensation achieved by ASIC. The Australian shareholder class actions involving GIO and Aristocrat were awarded A$112million and A$145million respectively, however in these cases no action had been (or was) undertaken by the Australian corporate regulators.

The Australian position on the deterrence impact of class actions has developed in the last 12 years as the class action regime has taken hold, but it is now recognised widely by the regulators (Cooper 2005, Samuel 2006) and the Australian courts are also starting to accept the regulatory deterrent role of class actions. In 2008 a Federal Court judge stated: "*While there are problems with securities class actions, it must, I think, be accepted that they serve a useful function. It is often said that these actions promote investor confidence in the integrity of the securities market. They enable investors to recover past losses caused by the wrongful conduct of companies and deter future securities law violations.*" (Finklestein 2008).

It is contended that it is likely that the class action results will have a more significant impact on corporate disclosure behaviour than the penalties achieved by the regulators. Under deterrence theory it follows that rational economic agents will act to avoid or mitigate such extreme penalties. Consequently it can be expected that corporations may be motivated to produce ESG reports to demonstrate their compliance. Following Hopwood it may also be argued that corporations may, *"with skill and a fair amount of planning and thought"* (2009, p.146), be motivated to produce ESG reports which are designed to obfuscate the readers of such reports including regulators and potential civil claimants.

4. Conclusion

The class action regime is relatively new in Australia in terms of application. The history and ongoing occurrence of corporate recidivism in Australia and around the world are evidence that regulatory bodies have difficulty in effectively mediating corporate environmental, social and governance behaviour. It is acknowledged that class action civil suits play a significant role in reinforcing existing corporate and consumer legislation. It is proposed that civil class actions have a deterrent effect on the ESG behaviour of corporations and it is contended that firms, particularly those in 'sensitive' industries, are motivated to produce corporate ESG reports as evidence of their compliance partly in order to avoid such civil suits.

It is recognised that much of the existing SEA literature is focussed on understanding the motives of corporations choosing to produce ESG reports. This paper recognises the inherent complexity of the motivating forces behind the strategic ESG disclosures of corporations (Hopwood 2009). Confirming Hopwood's (2009, p.437) call for urgent research into the motivations behind corporate environmental reporting, deterrence and avoidance of civil regulatory action is proposed as an alternate motivation for such reporting, and an area for future research.

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[i] In the SEA literature and in public practice such reports are referred to by a number of different names including Sustainability reports, Corporate Social Responsibility (CSR) reports, Corporate Social Disclosure (CSD) reports, Global Reporting Initiative (GRI) reports, Corporate Responsibility reports, Triple Bottom Line (TBL) reports, and a range of others. In this paper such reports are referred to collectively as Environmental, Social and Governance (ESG) reports.

[ii] Following from Owen (2008), in describing a research approach as 'critical' we do not intend to enter into a polemic about different ontological approaches to research or different research methodologies, nor do we wish to label or marginalise the critical perspective (Everett 2007). Our intent, instead, is to acknowledge (perhaps clumsily) that most (if not all) SEA researchers come subjectively to the research field seeking change in social and environmental accounting policy and practice.