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ESG Reporting – Class actions, Deterrence, and Avoidance

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Structured Abstract:

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<td>Within this paper it is argued that part of the motivation for some corporations to increase ESG disclosures is to avoid, or mitigate, the risk of class actions and the associated financial penalties. This paper proposes that in Australia the deterrence impact, and ancillary avoidance behaviour, of civil litigation class action provides a further motivation for improving both corporate ESG disclosure and sustainability performance.</td>
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<td><strong>What is original/value of paper</strong></td>
<td>This paper extends the Social and Environmental Accounting (SEA) reporting literature by proposing deterrence theory and avoidance as a corporate motivation for Environmental, Social and Governance (ESG) reporting. Deterrence is proposed as a different, yet complementary, motivation to the oft cited variations of stakeholder and legitimacy theory which are dominant in the SEA reporting motivation literature.</td>
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Key Words: Social and Environmental Accounting, Corporate Governance, Deterrence Theory, Corporate Social Reporting, ESG
Introduction

In a number of class action suits conducted in Australia damages awarded against corporations have been significantly higher than penalties levied by the corporate regulator and, in some cases, have been catastrophic for the corporations involved and their managers (Murphy, 2010). Access to the class action regime in Australia only became available in 1992. Since that time the number of class actions and the disparate corporate misbehaviours they target has increased and changed the regulatory environment for Australian business. This paper contends that the fear of exposure to these significantly increased penalties awarded through class actions will motivate corporations to employ a variety of risk reduction strategies, such as ESG reporting, in order to avoid or mitigate these costs. This conceptual paper contributes to the extant environmental, social and governance (ESG) reporting literature by proposing that, in this new business environment, deterrence theory and its associated concept of avoidance can offer a complementary explanation of the underlying corporate motivations to prepare ESG reports.

General deterrence theory is a widely used criminological theory which is regarded as a rational economic choice model having been extended to encompass economic considerations (Becker, 1968; Nussim & Tabbach, 2009). In utilising deterrence theory and its related concept of avoidance this paper extends the notion of rational economic self interest inherent in wealth maximisation models and adopts a characterisation of corporations and their agents as profit-driven “amoral calculators” whose decisions are purely influenced by economic cost and benefit calculations (Kagan & Scholz, 1984). Within this paper it is contended that multiple motivations drive corporate decision-making around the preparation of ESG reports. In proposing a new motivating influence this paper expands our understanding of the motivations behind corporations voluntarily reporting on ESG issues.

The paper is structured as follows; it firstly outlines the origins of deterrence theory, the associated concept of avoidance, and the expansion of deterrence theory to encompass neoclassical concepts of economic rationality. Within the criminology literature, corporate regulatory breaches are identified as being the outcomes of the rational decision making processes of organisations that are characterised as ‘amoral calculators’. Consequently, corporate behaviour that will breach regulations will be deterred by economic penalty costs of such breaches.

The paper then draws from the SEA literature to document the extent of prior research into voluntary corporate ESG reporting behaviours including the identification of a number of theories, in particular legitimacy theory, which have been used to explain the rationales for such reporting. Also identified are calls from within this literature for further research into the possibility that a variety of motivations drive such behaviour to promote a deeper understanding of the complexity of corporate ESG reporting behaviour (Buhr, 2007; Hopwood, 2009).
In response to this call, the paper proposes deterrence theory, as a complementary explanation of ESG reporting motivation. It is proposed that organisational regulatory breaches, where not accidental, are rational evaluations of risk and return conducted by corporations who can be characterised as amoral calculators. The paper then proposes that this extension of neoclassical deterrence theory leads companies to invest in strategies, such as ESG reporting, to both avoid and or mitigate possible penalty costs.

The paper notes the limitations faced by corporate regulators in influencing corporate behaviour and ESG practices and in particular the low level of legislated penalties that can be imposed on corporations. The paper then argues that where the cost of ESG compliance exceeds the potential regulatory penalty costs a rational, but amoral, corporation will choose to breach and risk the penalty. Evidence of the different penalties imposed as a result of class actions is provided and contrasted with the penalties achieved by the regulator for the same ESG breaches. It is then proposed that, under the tenets of deterrence theory and avoidance, the threat of the increased penalties resulting from class actions will lead wealth maximising organisations to increase their investment in either avoidance or compliance activities. It is hypothesised that increased or modified ESG disclosure will be one of the corporate communication behaviours undertaken. The paper concludes by outlining potential areas for future research and highlighting the contribution made to the SEA/ESG reporting literature by proposing deterrence theory and avoidance as an additional explanation of managers’ ESG reporting behaviour. This theoretical approach is proposed as a complement to the dominant lens of legitimacy theory.

The paper theorises an expanded understanding of the role(s) played by ESG reporting, and accounting more generally, as an information source mediating the dialogue between organisations and the society within which they operate (Gray, Kouhy, & Lavers, 1995). The paper responds to the call of Hopwood (2009) to develop new understandings of the variety of motivations underpinning ESG reporting decisions. These ESG communications form part of the discourse which forms the current hegemonic organisation-society dialogue. This paper enriches our understanding of the complex nature of the ongoing and evolving discourse between firms and society and informs regulators, policy makers, and practitioners.

**Background**

‘Environmental, social and governance’ (ESG) reporting is a term used widely in the capital markets to describe formal corporate reporting outside the published financial reports required under the Accounting Standards (see, for example, UNPRI 2011). In the Social and Environmental Accounting (SEA) literature and in public practice such reports are referred to by a number of different names including, but not restricted to, Sustainability Reports, Corporate Social Responsibility (CSR) Reports, Corporate Social Disclosure (CSD) Reports, Global Reporting Initiative (GRI) Reports, Corporate Responsibility Reports, and Triple Bottom Line (TBL) Reports. In this
paper such reports are referred to collectively as Environmental, Social and Governance (ESG) Reports. In positioning this paper within the literature the authors contend that Environmental, Social, and Governance (ESG) issues fall within the realm of SEA research.

An increasing number of international firms have been voluntarily publishing stand-alone ESG reports detailing their 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 social responsibility reports from 52% in 2005 to 79% in 2008 (2008, p. 14) but provided no definitive explanation as to why the increase occurred.

This jump in the level of ESG reporting should imply that ESG issues are increasingly recognised by corporations as being important. Given this increased importance a concomitant increase in the level of corporate sustainability performance could be expected. Yet despite the significant increases in companies preparing ESG reports there continues to be a large number of ESG-related corporate failings (American Association for Justice, 2010). It can be argued that the seemingly ubiquitous occurrence of corporate governance misbehaviour, such as the recent BP Gulf of Mexico disaster and the News of the World phone hacking controversy, support the characterisation of corporate misbehaviour by Cox and Thomas (2009a), as being at best episodic, and at worst as being systematic.

These breaches of community ESG expectations continue to occur despite the fact that protective environmental and governance regulations, of varying strength, are in place in most advanced economies. The recurrence of corporate ESG failures, and the resultant social and environmental damage that has invariably ensued, make it apparent that current 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, the increased occurrence and success of class action litigation has resulted in corporate misbehaviour being more regularly, and more severely, sanctioned. These class actions have embraced all three dimensions of ESG, examples of which include (but are not limited to): environmental (Cranbourne Gas – environmental damage), social (AWB – ethics of kick-back payments), and governance (Centro case and Oz Minerals- accounting disclosure breaches). In a report that detailed Australian class actions until 2009 it was found that class actions were issued for a range of different corporate misbehaviour (Morabito, 2009). Of all class actions issued up to 2009 22.4% were based on product liability claims, 17.4% were issued over industrial/workplace claims, migration and refugee issues accounted for 10.3%, 9.9% were shareholder class actions, and 8.2% related to
consumer protection issues (Morabito, 2009, p. 26). The class action regime has provided a mechanism through which significant civil damages are being awarded against corporations for ESG breaches. This economic deterrence is proving to play an important complementary role to regulation in moderating corporate ESG behaviours (Murphy & Cameron, 2006).

**Deterrence Theory and Avoidance**

**Deterrence theory**

Classical deterrence theory is generally recognised as being first formulated in the works of utilitarian philosophers Cesare Beccaria (1809) and Jeremy Bentham (1843) (both cited in Anderson, Harris, & Miller, 1983) and holds that crime is deterred by the threat of punishment. The deterrence impact of the threat of punishment is mediated by the severity of the punishment and the likelihood of the punishment occurring (Anderson, et al., 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 (Anderson, et al., 1983).

Becker (1968) used economic theory and fiscal psychology to expand deterrence theory to include the conceptualization of expected gain in the decision model of potential criminals. Becker’s (1968) neo-classical approach, combining the theory of rational choice with the utility maximizing rationale from economics, posed criminal behaviour as a rational economic choice.

Under the conventional formulation of general deterrence theory, deterrence is a rational choice function of the probability of detection and the level of sanction associated with that detection. Neo-classical deterrence theory contends that those considering an illegal act utilise probability of detection and financial value of the penalty to undertake a cost-benefit analysis of the crime. In such cases

> “the potential wrongdoer, in deciding whether to misreport her firm’s earnings … weighs her perception of the private gain … against her perception of both the chance that she will be caught and the consequences” (Sanchirico, 2006, pp. 1345-1346).

Both the general and specific models of deterrence are rational choice models which imply that the decision to commit a crime involves a rational decision process. Within the criminal sociology literature, limitations of deterrence theory arise from arguments of bounded rationality, where actors are said to lack the capacity to conduct a rational analysis of the cost and benefits of their actions (Paternoster, 2010). For example people committing crimes which are based on family ties, passion or ideology are not deterred by the threat of punishment and do not undertake a rational assessment of the potential impact of their actions (Paternoster, 2010).
Whilst deterrence theory has limitations in describing criminal decisions made in the case of crimes of passion and anger, in which the rational decision process may be curtailed, that is not necessarily the case with corporate crime. Braithwaite and Geis argued that deterrence would be more effective with 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).

Corporations have a number of advantages when it comes to rational decision-making including access to superior resources to acquire knowledge of the potential cost and benefits of their actions. Accordingly corporations are better placed than individuals to understand and respond to the potential of punishment captured by the doctrine of general deterrence (Fisse & Braithwaite, 1993, pp. 45-46).

Further, Pearce noted that “corporate crimes are, above all, organizational crimes” (Pearce, 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).

Kagan and Scholz (1984) characterised corporate regulatory non-compliance as fitting within three behavioural typologies: organisational incompetence, political citizens, or amoral calculators. Firms who breach regulations through ‘organisational incompetence’ do so through organisational failure stemming from a lack of system or process in dealing with regulatory requirements. In comparison ‘political citizen’ firms breach regulations as a result of “principled disagreement with regulations … they regard as arbitrary or unreasonable” (Kagan & Scholz, 1984, p. 68). The ‘amoral calculator’ firms are those motivated entirely by profit that “carefully and competently assess opportunities and risks …. Non-compliance stems from economic calculations” (Kagan & Scholz, 1984, p. 67).

In the modern business world corporations and their managers are being driven by the expectation of ever-increasing levels of economic success. Corporate decision-making is heavily influenced by economic rationality. A corporation is an amoral calculator if in contemplating a decision to breach a law it only considers economic factors in reaching a decision. This is not to suggest that all or any corporate decisions are immoral, rather that those decisions are made without any reference to moral codes. The characterisation of corporate behaviour as amoral has widespread
acceptance as an explanation for corporate and other institutional misconduct (Vaughan, 1998). Vaughan argues that business decisions of this nature “appear to be imbued with intent, calculation of costs and benefits, and some degree of forethought about harmful consequences” (1998, p. 24). When corporations decide to break environmental, social or governance laws based on economically rational analysis driven by the corporate goal of economic success they can be characterised as acting as “amoral calculators” (Kagan & Scholz, 1984). For these firms deterrence will be a consideration.

**Avoidance**

Associated with the general theory of deterrence is the concept of avoidance. Avoidance is where offenders expend resources on activities to decrease both the chance of detection and any anticipated punishment by reducing the probability of that punishment, or by limiting the penalty if detected (Nussim & Tabbach, 2009; Sanchirico, 2006).

Becker’s (1968) neo-classical explanation of deterrence theory focuses solely on the probability of detection without investigating the manner in which violators can reduce their chance of being caught. However, the concept of avoidance was contemplated by Beccaria, one of the originators of deterrence theory, who contended

> “The worse the ill that confronts them, the more men are driven to evade it. The very savagery of a punishment has this effect, and to avoid the penalty for one crime they have already committed, men commit other crimes” (Beccaria, 1764 at 3-44, cited in, p.1350; Sanchirico, 2006).

It is argued that it is “difficult to avoid the conclusion that violators are more than mere spectators. Just as the state invests in detecting their violations, they invest in avoiding that detection” (Sanchirico, 2006, p. 1350). The concept of avoidance extends neo-classical deterrence theory by considering the range and cost benefits of strategies used to avoid detection and to mitigate penalties when detection does occur (Sanchirico, 2006).

It is contended that corporations who rationally commit breaches of environmental, social or governance laws will just as rationally expend resources on avoidance strategies which may include ESG reporting designed to

*increase their legitimacy in the wider world. Not only that, they can also have an interest in using reporting to facilitate the construction of a new and different image of the company. To the extent that such strategies work, it is possible that fewer questions might be asked of the legitimated organization and thereby less might be known of it. It is as if the report serves as a corporate veil, simultaneously providing a new face to the outside world while protecting the inner workings of the organization from*
Motivations for ESG Reporting

Social accounting and the extant SEA literature encompasses a broad landscape of differing theoretical viewpoints and methodological approaches (see for example Mathews, 1997; Owen, 2008; Parker, 2005). There have been a number of reviews published on the content, direction and themes of the SEA literature (see for example Ball & Milne, 2007; Deegan & Soltys, 2007; Mathews, 1997; 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.

Owen’s review of the SEA research 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 finding reflects a concentration of studies within the broader SEA literature which have focussed on the motivations of corporations engaged in voluntary ESG reporting and on estimating the putative information value of such reports to stakeholder (see for example, Cho & Patten, 2007; de Villiers & van Staden, 2006, 2011; Deegan, 2007; Deegan, Rankin, & Tobin, 2002; Deegan, Rankin, & Voght, 2000; Gray, et al., 1995; Munilla & Miles, 2005; Roberts, 1992; Wilmshurst & Frost, 2000).

Unerman[4] in 2007 identified that there were two broad perspectives surrounding the academic investigation of organisational motives for preparing ESG reports. The first approach is that ESG reporting aims to transform business practice to move the organisation closer to a state of environmental and social sustainability. The other perspective holds that firms engage in ESG reporting as a tool by which they can win or retain the support of key stakeholders. The majority of academic studies undertaken have considered such motivations through the lens of political economy, and have largely utilised stakeholder and legitimacy theory as explanatory models (Lehman, 2001).

Legitimacy has been defined as “a condition or status which exists when an entity’s value system is congruent with the value system of the larger social system of which the entity is a part” (Lindblom, 1994, p. 2). If firms are perceived as being in breach of their notional social contract they face the risk of having society withdraw support and resources. It is argued that when firms behaviour is perceived to be in conflict with society expectations they will undertake legitimation activities in order to gain social acceptance (Deegan & Gordon, 1996). In contrast, the notion of deterrence and avoidance suggests that the primary driver of firm actions in relation to ESG is the financial cost imposed by society through penalty mechanisms such as
regulation or class action. Under deterrence theory firms can be considered to be amoral calculators who, rather than undertaking legitimation activities aimed at meeting community standards or some notional social contract, make decisions on ESG matters purely on a rational cost benefit basis with penalties included as one of the costs.

Deegan and Rankin (1996) examined disclosure practices of firms prosecuted by Environmental Protection Authorities in NSW and Victoria and found that prosecutor action by the regulator signalled a significant change to disclosure practices by Australian companies. Where companies were prosecuted there was significantly more positive information reported than included in the ESG reports of those corporations not being prosecuted. Legitimacy theory was used by Deegan and Rankin (1996) to explain the changes in disclosure however it is contended that deterrence theory and avoidance could provide an alternative and complimentary explanation. Indeed Deegan and Rankin allude to the avoidance impact of such reporting and argue their results were “consistent with a view that the companies may increase their disclosures to offset, at least in part, the effects of any EPA prosecution” (1996, p. 58). Similarly, de Villiers and van Staden concluded that corporate managers provided additional ESG information in “order to show they are taking appropriate action and to thereby avoid political actions, such as consumer boycotts or additional regulation” (2011, p. 521).

Within the SEA reporting literature there is no agreement on a single theoretical model which underpins the motives of firms’ to report. Hopwood contends that “it is clear that a variety of motives may well be implicated in the production of environmental and sustainability reports” (Hopwood, 2009, p. 438). This supports Buhr’s reflection on sustainability reporting behaviours which concluded that corporate rationales to explain disclosure practices “did not operate in isolation” (Buhr, 2007, p. 63). 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, pp. 437-438). In this paper it is contended that deterrence theory, driven by the emerging threat of class actions around ESG issues, may provide a complementary motivation for firms to prepare ESG reports.

**Regulatory Challenges**

A criticism within the SEA literature has been the slow rate of identifiable change in corporate behaviours around ESG issues both in Australia and internationally (Ball & Milne, 2007). Murray *et al.* (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 inability of regulators to closely and effectively control financial markets in order to enforce the adoption of ESG practices by firms.
The level of corporate wrongdoing in Australia seems undiminished despite the corporate watchdogs having greater powers than at any previous time in Australia’s history. In Australia the key corporate regulators are the Australian Securities and Investment Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC). It can be argued that corporate regulators will never effectively regulate because they are captured within political processes which act to protect large corporations (Bendell & Kearins, 2005). This influence on governmental regulatory behaviour can be manifested in the form of financial contributions, lobbying, the threat of capital flight and, indirectly, through corporate influence of media and political discourse (Bendell & Kearins, 2005, p. 374). This capture can be reflected in regulators being under-funded and poorly resourced and result in an “immense imbalance in terms of power between corporations (or corporate capital) on the one hand, and regulatory agencies on the other” (Pearce & Tombs, 1990, p. 428).

In Australia regulatory financial penalties are set by statute and as such are capped and known. A rational choice to breach a regulation, under neo-classical deterrence theory, becomes purely a calculation. This calculation accounts for both the probability and cost of detection, weighing these against the expected economic benefit which will accrue to the corporation as a result of breaching the regulation. Where the cost of ESG compliance exceeds the likely cost of punishment a rational, yet amoral, economic actor will choose not to comply with regulation.

Deterrence theory is particularly relevant for these profit-oriented ‘amoral calculator’ entities as 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 both the perceived risk and financial cost of being detected rises, wealth maximising organisations will increase their investment in compliance or avoidance activities (Thornton, et al., 2005). When choosing avoidance activities firms aim to decrease both the probability of detection and the amount of the associated punishment (Nussim & Tabbach, 2009; Sanchirico, 2006).

**Class Actions**

Regulatory regimes generally operate to penalise corporate misbehaviour rather than to compensate shareholders for losses resulting from breaches of the law by corporations and their officers (Murphy & Cameron, 2006, p. 244). The central purpose of the Australian class action regime is to provide a mechanism, through the aggregation of individual claims, which allows access to justice for individuals seeking redress from defendants who are typically both wealthier and more powerful (Murphy & Cameron, 2006). Rather than the capped and known legislated fines for breaching the law, under the class action regime defendant firms are held responsible for the unlimited losses or damages incurred by plaintiffs who have been affected by the defendants’ poor ESG behaviour.
Class action litigation has been available in Australia since 1992 with the amendment to Part IVA of the *Federal Court Act*. The Australian legislation also recognises that in a global economy civil wrongs can be perpetrated on a mass scale by large entities (Murphy & Cameron, 2006). These large corporations generally have an advantage over wronged individuals in any consequent litigation or dispute resolution due to experience developed from a history of similar litigation and because of their ‘deep pockets’ (Murphy & Cameron, 2006, p. 402). The class action legislation is clearly 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 McKenzie, 1883, p.222, cited in Murphy & Cameron, 2006). 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).

In the United States of America (USA), 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 regulatory 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” (Law Reform Law Reform Commission, 1988, p. 33). 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 relating to governance issues (Legg, 2008; Murphy & Cameron, 2006).

**Public and Private Regulation**

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, ASIC and the ACCC. Jeremy Cooper, when Deputy Chair of ASIC, stated that shareholder class actions
had a useful role to play in “maintaining the integrity of the equity capital market”. Cooper further 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).

ASIC is the public corporate regulator in Australia empowered by the Corporations Act 2001 (Cth) and the Australian Securities and Investment Commission Act 2001 (Cth) to apply sanctions against corporations and individuals. In recent years much of ASICs focus has been on enforcing the regime of continuous disclosure brought in as part of the Corporate Law Reform Act 1994 (Cth). This legislative change aimed to ensure a fair and transparent financial market by mandating disclosure of price sensitive information to the market in a timely manner. The regulatory landscape has altered over time, ASIC has been granted more power to issue a wider range of criminal and civil sanctions including enforceable orders and infringement notices. Originally ASIC were limited to seeking statutorily limited civil penalties through the court system. These chronological changes to legislation designed to facilitate ASICs regulatory role are well covered by Lohrisch (2012) who also points out that ASIC has in fact sanctioned very few corporations since being granted extra powers in 1994.

In terms of sanctions available for governance breaches ASIC has the option of undertaking lengthy (and costly) court action to obtain a civil penalty order limited to $1 million or issue an infringement notice limited to $100,000. Examples of the enforcement results achieved in Australia by ASIC for a sample of corporate breaches are provided in Table 1 which can be contrasted with the results achieved using class actions to recover investor losses as a result of similar breaches presented in Table 2.

Table 1: Outcomes of Regulator Action (ASIC, 2012; King & Wood Mallesons, 2012; Maurice Blackburn, 2012; Murphy, 2010)

<table>
<thead>
<tr>
<th>Enforcement activities</th>
<th>ASIC Media Release.</th>
<th>Resolved</th>
<th>Result ($ Australian)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crown Casino Ltd</td>
<td>98-277</td>
<td>1998</td>
<td>No civil financial penalty. Enforceable undertaking to improve compliance</td>
</tr>
<tr>
<td>Southcorp Ltd</td>
<td>03-070</td>
<td>2003</td>
<td>$100,000 fine – First successful civil penalty</td>
</tr>
<tr>
<td>Solbec Pharmaceuticals Ltd –</td>
<td>05-223</td>
<td>2005</td>
<td>$33,000 fine – First use of infringement notice</td>
</tr>
<tr>
<td>Chemeq Ltd</td>
<td>06-246</td>
<td>2006</td>
<td>$500,000 fine – Largest fine under infringement notice</td>
</tr>
<tr>
<td>GIO</td>
<td>06-261</td>
<td>2006</td>
<td>$370,000 fines on Directors</td>
</tr>
</tbody>
</table>
The Crown Casino undertaking was the first achieved by ASIC under the new continuous disclosure regimes and the regulator did not seek a financial penalty, despite evidence that the company was aware of, and had sought legal opinion on, its disclosure requirements. Chemeq Pty Ltd was fined a total of $500,000 under a civil penalty order for two admitted breaches of the ASX continuous disclosure requirements, one of which ran over several months whilst the company raised $45 million of equity capital (ASIC, 2006a). Jeffrey Lucy, Chairman of ASIC commented that this was (at that time) “the highest penalty awarded in Australia against a listed company for breaches of continuous disclosure rules” (ASIC, 2006a). Whilst being the highest penalty imposed to that date the $500,000 penalty was well short of the maximum penalty of $2.2 million that could have been imposed under the regulation.

The Solbec fine of $33,000 in 2005 represents the first successful use by ASIC of the newly introduced infringement notice regime.

The Nufarm case represents a case which was subsequently the subject of a shareholder class action. In this case ASIC opted to obtain an Infringement Notice limited under the regulation (based on the firm’s size) to $66,000 rather than undertake costly and lengthy legal action to achieve a civil penalty (limited to $1 million). In the Multiplex case, where a class action was also launched, ASIC accepted an enforceable undertaking of a $32 million compensation payment rather than be limited to a $1 million civil penalty. Finally, the three breaches by Leighton Holdings for not disclosing in a timely manner deteriorating financial projections during 2012 were dealt with by infringement notices. This implies ASIC was of the view that the matters were “relatively minor contraventions of the continuous disclosure provisions of the Corporations Act” (Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004, para 5.255). These breaches by Leighton’s are currently the subject of a yet to be launched class action which its promoters are estimating to be worth $400 million (ABC NEWS, 2011).
All of the cases in Table 1 are drawn from actions undertaken by ASIC primarily for breaches of the continuous disclosure governance regime. It is noted that other regulatory action can and have been undertaken and that up until 2009 only 11% of class action cases in Australia were related to such breaches. For example, cartel behaviour by cardboard producer Visy was the subject of action by the ACCC which in 2007 resulted in penalties of $38 million (including individual fines for company officers of $2 million). It is noted that Amcor the co party to price fixing was granted immunity from the ACCC action.

There is evidence that the financial penalties imposed on corporations following grouped class actions is significantly higher than the penalties applied as a result of regulatory action (see, for example, Murphy, 2009). Penalties levied following court action by the Australian regulator (see Table 1) can be typically measured in the hundreds of thousands of dollars whereas penalties awarded through litigation under the class action regime in Australia are more realistically measured in the millions of dollars (Table 2).

Table 2: Outcomes of Civil Class Actions (King & Wood Mallesons, 2012; Maurice Blackburn, 2012; Murphy, 2009)

<table>
<thead>
<tr>
<th>Class action</th>
<th>Allegation</th>
<th>Resolved</th>
<th>Result ($ Australian)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GIO Australia Ltd</td>
<td>Misleading representations in take over</td>
<td>2003</td>
<td>$112 million</td>
</tr>
<tr>
<td>Tracknet</td>
<td>Misleading statements in prospectus</td>
<td>2004</td>
<td>$4.3 million</td>
</tr>
<tr>
<td>Concept Sports Ltd</td>
<td>Misleading statements in prospectus</td>
<td>2006</td>
<td>$5 million</td>
</tr>
<tr>
<td>Aristocrat Leisure Ltd</td>
<td>Continuous Disclosure – accounting misstatement</td>
<td>2007</td>
<td>$145 million</td>
</tr>
<tr>
<td>Telstra</td>
<td>Continuous Disclosure – unfair analyst briefing</td>
<td>2007</td>
<td>$5 million</td>
</tr>
<tr>
<td>Downer EDI Ltd</td>
<td>Continuous Disclosure – asset write-downs</td>
<td>2008</td>
<td>Approx $20 million</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(confidential)</td>
</tr>
<tr>
<td>Multiplex Group Ltd</td>
<td>Continuous Disclosure – revenue write-downs</td>
<td>2010</td>
<td>$110 million</td>
</tr>
<tr>
<td>AWB Ltd</td>
<td>Continuous Disclosure – illegal kickback payments</td>
<td>2010</td>
<td>$39.5 million</td>
</tr>
<tr>
<td>Oz Minerals</td>
<td>Continuous Disclosure – accounting misstatement of debt</td>
<td>2011</td>
<td>$55 million</td>
</tr>
<tr>
<td>Cranbourne Gas Leak</td>
<td>Environmental Law breach</td>
<td>2011</td>
<td>$23.5 million</td>
</tr>
<tr>
<td>Visy</td>
<td>Cartel behaviour</td>
<td>2011</td>
<td>$120 million</td>
</tr>
<tr>
<td>Centro Property Group</td>
<td>Continuous Disclosure – accounting misstatement of debt</td>
<td>2012</td>
<td>$200 million ($67M Auditors PricewaterhouseCoopers $133M Centro group)</td>
</tr>
<tr>
<td>Nab</td>
<td>Continuous Disclosure – deceptive conduct</td>
<td>2012</td>
<td>$115 million</td>
</tr>
<tr>
<td>Nufarm</td>
<td>Continuous Disclosure</td>
<td>2012</td>
<td>$46.6 million</td>
</tr>
<tr>
<td>Leighton Holdings</td>
<td>Continuous Disclosure – changed operational performance</td>
<td>Ongoing</td>
<td>$400 million (estimate)</td>
</tr>
</tbody>
</table>
There have been several cases where there have been concomitant regulatory action and class action suits and several suits where class actions for breach of regulations were successful yet no penalties were imposed by the relevant regulator. For 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 the issuance of any private suit. As a consequence of the regulator’s legal action, the corporation was required to undertake to improve compliance and establish a $32 million compensation fund for investors (Murphy, 2009). In contrast, the class action civil suit against Multiplex, which was issued after the regulator’s action was completed, resulted in a settlement for an additional $110 million for investors (Murphy, 2010). This figure was more than three times as large as the compensation achieved by ASIC through regulatory action and resulted in a total financial compensation cost to Multiplex of A$142 million.

Similarly, the Australian shareholder class actions involving governance and accounting breaches by GIO and Aristocrat resulted in financial penalties of A$112 million and A$145 million respectively (Murphy, 2009). In these cases, despite the regulators being made aware of the alleged breaches, no regulatory penalty was awarded against the corporations whilst financial penalties, which can be measured in the hundreds of thousands of dollars, were levied against some of the corporate officers involved (ASIC, 2006b). A sample of cases demonstrating the disparity between the financial penalties achieved by the regulator compared with those achieved from class actions are set out in Table 3.

Table 3: Comparison of Financial Penalties: Regulator v. Class Action

<table>
<thead>
<tr>
<th>Firm</th>
<th>Regulator $ Penalty</th>
<th>Class Action Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>AWB Ltd</td>
<td>$100,000 Managing Director fine (some cases outstanding)</td>
<td>$39.5 million</td>
</tr>
<tr>
<td>Centro</td>
<td>$30,000 CEO fine (cases outstanding)</td>
<td>$200 million</td>
</tr>
<tr>
<td>Multiplex Group Ltd</td>
<td>$32 million</td>
<td>$110 million</td>
</tr>
<tr>
<td>Visy</td>
<td>$38 million</td>
<td>$120 million</td>
</tr>
<tr>
<td>Nufarm</td>
<td>$66,000</td>
<td>$46.6 million</td>
</tr>
<tr>
<td>GIO</td>
<td>$370,000</td>
<td>$112 million</td>
</tr>
<tr>
<td>Aristocrat</td>
<td>none</td>
<td>$145 million</td>
</tr>
<tr>
<td>Cranbourne Gas Leak</td>
<td>none</td>
<td>$23.5 million</td>
</tr>
</tbody>
</table>

It is interesting to note that following the class action against the Multiplex Group the firm released its first ever ESG reports in 2010 and 2011. Similarly, Visy set in place a Governance Board tasked with creating policy and overseeing corporate actions with relation to conduct and competition, and directly related to the price fixing breaches for which the company was charged. In addition policy was enacted by Visy to address improper conduct and to provide protection to whistleblowers. While these policies will not guarantee that breaches will not occur in the future it can be argued that as a result of the significant financial penalty imposed as a result of the
class action, Visy is taking more seriously the need to specify expectations of directors and managers resulting in a change to the way business is conducted.

The Cranbourne Gas Leak case extends the deterrence impact of class actions beyond the corporate entities to include regulatory authorities with the Environmental Protection Authority (EPA) Victoria joined with the City of Casey as a co-defendant. As a result of the class action against the EPA Victoria, and the associated investigation and report by the Victorian Ombudsman, the EPA has acted to implement all of the Ombudsman’s recommendations (EPA Victoria, 2012). These recommendations have included improvements to aspects of statutory decision making processes, annual performance statements for licensed sites to report on environmental performances, record keeping and file management systems improved, policies in respect to design and management of landfill sites and the need to reform the EPA’s approach to compliance and enforcement.

It should be noted that in addition to the financial penalties imposed the “size and complexity of class actions means they can be unwieldy and lengthy, giving rise to substantial costs” which can involve the expenditure of many millions of dollars in legal costs by each side (Legg, 2008, p. 700). For example, it was estimated that more than $40 million was spent by all parties in the GIO class action and more than $30 million in the Aristocrat class action (Murphy, 2009). In addition further opportunity costs are incurred as management are diverted from their core business to defend class actions involving instructing lawyers, providing witness statements, and attending to evidentiary discovery (Legg, 2008). The defendant firm may also suffer consequential reputational damage and a depressed share price as a result of publicity around the class action (Legg, 2008).

Given the potentially high cost of the outcomes of the class action regime it is not surprising to find change impacting on the way business is conducted. These responses include both action undertaken by firms, as noted above, but also influenced the way directors approach their duties. In a survey of company directors conducted by Mallesons Stephen Jaques (2012) it was found that 65% of directors felt that the rise in class actions was a concern and that over a third indicated that they now gave greater attention to class action issues than they had in the previous twelve months.

Discussion

The deterrence impact of class actions in Australia has developed as the class action regime has taken hold and is now widely recognised by the regulators (Cooper, 2005; Samuel, 2006). The Australian courts are also starting to accept the regulatory deterrent role of class actions. In a recent Australian class action hearing the Federal Court Justice stated

“while there are problems with securities class actions … they serve a useful function [as] these actions promote investor confidence in the
integrity of the securities market [and] enable investors to recover past
losses caused by the wrongful conduct of companies and deter future
securities law violations” (Finklestein, 2008).

Similarly, then ACCC Chairman Graeme Samuel welcomed the settlement of the Vitamins Cartel class action in Australia and the deterrence value of the $30.5 million award which was “a lesson to those that are involved in cartels” (Samuel, 2006).

Corporate strategies to avoid and mitigate the potential economic costs of ESG class action litigation can occur on a continuum of corporate behaviours. At one end of such a continuum it can be expected that corporations may be motivated to improve their ESG outcomes and will produce ESG reports, whether positive or negative, to demonstrate their commitment to ESG practices. At the other end, as argued by Hopwood, corporations may “with skill and a fair amount of planning and thought” (2009, p. 437) be motivated to produce ESG reports which are designed to obfuscate the readers of such reports, avoiding the attentions of regulators and potential civil claimants.

Hopwood recognised the legitimating impact of the voluntary preparation of ESG reports and argued that rather than enhancing transparency and visibility “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 has also been argued 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” (Cho, Roberts, & Patten, 2010, p. 431). Bendell and Kearin in their argument for mandatory rules and processes to govern corporate ESG behaviour described a ‘distraction effect’ and expressed concern that voluntary ESG activity “may be used by some corporations to distract society from more transformative approaches and diffuse regulatory innovations” (2005, p. 373).

The class actions discussed in this paper represent a selected group however class actions have embraced all three dimensions of ESG, for example: environmental (Cranbourne Gas – environmental damage), social (AWB – ethics of kick-back payments), and governance (Centro case and Oz Minerals- accounting disclosure breaches). The class action regime has provided a mechanism through which significant civil damages are being awarded against corporations for ESG breaches. This economic deterrence is proving to play an important complementary role to regulation in moderating corporate ESG behaviours (Murphy & Cameron, 2006).

The impact of class action is not limited to firms but can also embrace the regulator as seen in the Cranbourne Gas case. This was described by Ben Harwick from Slater & Gordon (2012) as

“a significant case for environmental law in Australia. This successful settlement sends a message to all councils and authorities managing
environmentally sensitive sites that it is critical to properly address the risks such as landfill gas migration, and to do it prudently..... It is pleasing that in 2010 the EPA stepped up to the plate and imposed strict environmental performance measures for the clean up of the site.”

This paper contends that the relatively recent development in Australia of the class action regime and the deterrence effect of the significant financial damages awarded against defendant corporations has the potential to motivate corporations to rethink their approach to environmental, social and governance issues and reporting. It is argued that the damages awarded under Australian class actions will have a more significant impact on corporate behaviour than the penalties achieved by corporate regulators. Under deterrence theory it follows that rational economic agents will act to avoid or mitigate such extreme penalties. The significant damages awarded could have been avoided if “there been some relatively cost-effective preventative measures adopted at an earlier time” (Slater & Gordon, 2012).

In this respect even amoral calculators, with little concern for ESG issues, will be motivated to avoid the potentially disastrous consequences of a class action suit. The actions contemplated by these amoral calculator firms will range between those firms which will avoid such risks, by identifying and rectifying breaches through action, and other firms which may wish to adopt strategies, including communication strategies, designed to mitigate the risk of class actions through a process of legitimation and misinformation. For example, the ESG reports issued post-class action by Multiplex are not in accordance with accepted reporting frameworks such as the GRI (Global Reporting Initiative, 2011).

It is not proposed that all firms do, or will, embrace an amoral and purely economic approach to the costs of complying with ESG issues. However, it is contended that the severe financial penalties which have already been imposed on corporations in Australia under the emerging class action regime may motivate firms to increase their ESG reporting to either improve ESG performance or to dissemble and disguise poor ESG performance. The imbalance in the positive versus negative disclosure found in firms prosecuted for environmental breaches discovered by Deegan and Rankin (1996) which they attributed to the firms desire for legitimacy, may in fact have also been partly motivated by avoidance. By bringing attention to their positive ESG activities the corporation would distract regulators and others and deflect attention from its ESG failures and the potential for class action litigation. Further should investigation and litigation take place they will have sought to mitigate responsibility and hence reduce financial penalty by the evidence of positive action reported (de Villiers & van Staden, 2011).

It is not a contention that deterrence theory will provide the sole motivation for firms preparing ESG reports, rather that, as posited by Hopwood (2009) this is but one of a range of motivations for firms to strategically prepare and issue ESG reports. A significant difference between the motivation to report afforded by deterrence and
avoidance theory and other theoretical explanations for such motivation previously identified in the SEA literature is that firms may be motivated purely on immediate economic grounds to change their ESG actions and reporting. Thus firms who, as amoral calculators, may feel no social responsibility to improve their ESG behaviours may nevertheless be motivated to change on purely economic grounds. Therefore this theoretical approach offers the potential for emancipatory change in corporate behaviour.

In explaining the rush by corporations, particularly those in ‘sensitive’ industries (Brown & Deegan, 1998), to produce sustainability reports this paper proposes deterrence and avoidance as a corporate motivation different, yet complementary, to the explanations provided by the variations of stakeholder and legitimacy theory which are dominant in the SEA literature. It is argued in this paper that part of the motivation for some corporations to increase ESG disclosures is to avoid, or mitigate, the risk of class actions and the associated extreme financial penalties.

**Role for SEA Accountants**

To ensure the transparency and accuracy of ESG reporting new roles for accountants are implied in order to address the potential ESG reporting-performance portrayal gap identified by Adams (2004). These new approaches to accounting will also seek to address the potential misuses of ESG reporting identified by (Bendell & Kearins, 2005; Cho, et al., 2010; Hopwood, 2009). These new roles were acknowledged by Gray (2010) in his call for SEA researchers to adopt new interdisciplinary and trans-disciplinary approaches. Boyce (2000) suggested that any attempt to involve social and environmental aspects in corporate reporting will necessarily 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. In this way social and environmental accountants will play a role in ensuring that ESG reporting is factual and meaningful and consequently more likely to result in change to actual corporate ESG behaviour and reduce the need for civil and regulatory legal actions.

**Conclusion and future research**

The class action regime is relatively new in Australia in terms of application. The history and ongoing occurrences 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 through the deterrent impact of civil class actions there will be a pressure on corporations to improve their ESG behaviour. 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 focused 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). Responding to Hopwood’s (2009, p. 437) call for urgent research into the motivations behind corporate environmental reporting, the mutual concepts of deterrence and avoidance are proposed as an additional motivation for such reporting, and an area for future research.

The impact of the significant disparity between economic penalties imposed under the regulatory and class action regimes on corporate ESG behaviour is the focus of ongoing research. This ongoing project includes an empirical study of Australian firms in sensitive industries to test whether the threat of class actions impacts on firms’ ESG reporting and behaviour. A further area of research would be to investigate the potential role of accountants in the determination of damages and penalties in ESG class action suits, particularly in actions involving social and environmental breaches.
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