

# 2018 DEAKIN LAW ORATION

## HUMAN RIGHTS AND GOOD CORPORATE CITIZENSHIP

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The first industrial revolution, which began in the late 18<sup>th</sup> century, focused on the benefits of water and steam power to mechanise production. Machines started to be used instead of human or animal labour. Although there had been pollution prior to this time, the emissions from mechanised factories were the beginning of the dangerous anthropogenic emissions as we know them today.

By the middle of the 19<sup>th</sup> century, wealthy families had contributed risk capital to organisations which had unlimited liability. In consequence, in addition to the risk capital, these wealthy families were also liable for all the claims of creditors and employees in the event of the bankruptcy of the organisation. They started to balk at this. As is the case today, the politicians of the time wanted more jobs to be created and started thinking of creating an artificial person with limited liability.

This met with opposition. It was Lord Thurlow, in 1844, who said ‘Corporations have neither bodies to be punished, nor souls to be condemned; they therefore do as they like’.<sup>1</sup> Lord Thurlow was correct, because the company is an artificial person which has no heart, mind or soul of its own. Directors, once appointed, become the heart, mind and soul of the company. This understanding gives content to the development from the 19<sup>th</sup> century of the common law fiduciary duties of directors to a company, of good faith and loyalty as well as duties of care, skill and diligence. Those are exactly the duties

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<sup>1</sup> John Poynder (ed), *Literary Extracts from English and Other Works* (J Hatchard, 1844) 268.

of the guardian of an incapacitated young human being. The common denominator is incapacity.

There were consequences of wealthy families providing equity capital and several of their members becoming directors of the company. One of those consequences was that other stakeholders, particularly employees, saw these shareholders as the owners of the company. Shareholders were also given primacy of place over all the other stakeholders involved in the business of the company: suppliers, creditors, financiers, employees, advisers, and so forth.

In the late 19<sup>th</sup> century and early 20<sup>th</sup> century, society underwent the second industrial revolution, with mass production driven by a constant flow of energy, primarily electricity. One of those benefiting from mass production was Henry Ford and the Ford Motor Company. There was great demand for his Model T Ford and in 1919 the company made an excessive profit of US\$60,000, probably US\$6 billion today. The Ford Motor Company announced that the company intended increasing the wages of its employees so that they could work longer hours during the week and weekends so that the company could meet the demand for its Model T Ford. The Dodge Brothers, who were minority shareholders of the Ford Motor Company Limited and later competitors, contended that the company had a duty to pay the excessive profits as a special dividend to shareholders before increasing the wages of employees because of the primacy of the shareholder. This was disputed by Ford.

The Dodge Brothers instituted an action in 1919 for a declaratory order that the Ford Motor Company was obliged to declare that excessive profit as a special dividend to shareholders before considering increasing the wages of employees.<sup>2</sup> The Supreme Court of Michigan upheld this contention and consequently the concept of the primacy of the shareholder became entrenched, as well as the view that directors should steer a company in such a way as to ensure the maximisation of shareholder wealth.

The concept of shareholder primacy was then reinforced by the Nobel Laureate economist Milton Friedman, who in the 70s wrote:

[T]here is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as

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<sup>2</sup> *Dodge v Ford Motor Co* 204 Mich 459, 170 NW 668.

it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.<sup>3</sup>

Tacit in that statement was that the company was not integral to society and that as long as the company was increasing its profits, without deception or fraud, it could do so at any cost to society or the environment. The consequence was that the governance of companies, right up to the end of the 20<sup>th</sup> century, was focused on increasing the monetary bottom line even if it was at a cost to society and the environment. It will be seen that directors were acting lawfully but causing the company to commit wrongs against society and planet Earth. The response of society represented by governments was to address the adverse impacts of a company's money-making actions with regulation — for example environmental impact laws — instead of tackling the source of the adversity. This source of adversity was the company's business model — how the board decided the company should make and distribute its money — with those decisions driven by the shareholder-centric governance model of the day — the maximisation of shareholder wealth.

During the second industrial revolution there were also the two great world wars. The second world war of 1939–1945 caused two Polish lawyers to flee the Nazi occupation of Poland. One emigrated to America, the other to the United Kingdom.

Both were concerned about the violation of human rights being carried out by the Nazis in Poland and subsequently in other places. Both became international law experts and questioned the international legal principle that the state has control over its citizens. With the atrocities being carried out by the Nazi regime, the professor who emigrated to America, Professor Raphael Lemkin, said that atrocities of such a kind should be recognised as a *sui generis* crime, and he coined the word 'genocide', developed from the Greek 'genos', 'race or tribe', and the Latin 'caedere', 'to kill'.<sup>4</sup> Professor Hersch Lauterpacht in the United Kingdom said that international law had to change to give the individual rights which should be universal and override state sovereignty over its citizens. He favoured the term 'crimes against humanity'.<sup>5</sup>

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<sup>3</sup> Milton Friedman, *Capitalism and Freedom: Fortieth Anniversary Edition* (University of Chicago Press, 2002) 133.

<sup>4</sup> United to End Genocide, *What Is Genocide?* <<http://endgenocide.org/learn/what-is-genocide/>>.

<sup>5</sup> Which had been used from 1890 by the American Civil War soldier, politician, and writer, George Washington Williams, in reference to the colonial activities of Belgium <<https://legaldictionary.net/crimes-against-humanity/>>.

Professor Lauterpacht's thesis was that governments must embrace the 'revolutionary immensity'<sup>6</sup> of a new international law that would protect the fundamental rights of the individual. The intent of his thesis, which is now part of international law, was that even if persons were leaders in a state they could not escape the 'outraged conscience of the world'<sup>7</sup> resulting from their crimes against humanity.

President Franklin D Roosevelt, in January 1941, said mankind should have four essential freedoms: freedom of speech, freedom of worship, freedom from want and freedom from fear.<sup>8</sup> His speech became the driver of the Nuremberg trials.

At the cessation of World War Two the conquering powers decided that the Nazi rulers had to be tried and punished for the atrocities they had inflicted on humanity. To the great disappointment of Professor Lemkin, the Nazi rulers were indicted for crimes against humanity. It was argued by the lead prosecutors, an Associate Justice of the US Supreme Court (and former Solicitor General and Attorney General) and an English Silk and UK Attorney General,<sup>9</sup> that no state could overrule the rights of the individual to life, liberty and security of person.

While international law was starting to oblige governments to act or to refrain from acting in certain ways, companies continued to lawfully carry on business as usual, namely maximising profit even if it was at a cost to society and the environment. The anthropogenic emissions from factories, plants, machinery and vehicles started exacerbating world pollution which had started as a result of the first industrial revolution. At the same time, in the second half of the 20<sup>th</sup> century, single use plastic in or with manufactured goods became the norm. Millions of tons of plastic were being manufactured each year and finding their way into landfills or rivers and subsequently into the oceans. Plastic has started polluting life below the blue line and an island of plastic waste twice the size of Texas has formed in the middle of the Pacific Ocean, the currents driving plastic buckets, plastic bottles, plastic bags and so forth into a mass of plastic waste. Also in the second half of the 20<sup>th</sup> century there was cheaper child labour

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<sup>6</sup> Phillippe Sands, *East West Street: On the Origins of 'Genocide' and 'Crimes against Humanity'* (Weidenfeld and Nicolson, 2016) 104.

<sup>7</sup> The phrase is taken from a letter from Hersch Lauterpacht to Patrick Dean, 20 August 1945, FO 371/51034.

<sup>8</sup> Franklin D Roosevelt, *1941 State of the Union Address* (Four Freedoms speech) Monday 6 January 1941.

<sup>9</sup> Associate Justice of the Supreme Court Robert H Jackson (United States) [Jackson was on leave from the Court] and Attorney General Sir Hartley Shawcross (United Kingdom).

in supply chains, and deforestation was decreasing the absorption of CO<sub>2</sub> emissions and the creation of O<sub>2</sub>.

Industrial farmers started fertilising their lands with chemicals and the rain washed these chemical fertilisers into streams and rivers which eventually found their way into the ocean. There are now dead zones in the oceans of the world where, due to diminished levels of oxygen in the water, marine life either dies or flees the area. These erstwhile habitats which had been teeming with life have become biological deserts. The sea life which escapes these dead zones is then caught in modern nets spread between two trawlers. As is well known, our seas have been overfished.

Society's reaction during the 20<sup>th</sup> century to these adverse impacts of companies' business models was to ask its governments to regulate against them and to expect NGOs to deal with them. Instead, society should have advocated that they be dealt with at the source. The problem lay in the primacy of the shareholders and how the company made its money. In medical terms, society tried to deal with the *symptoms* of 'profit at any cost' instead of the *cause*.

During the latter part of the 20<sup>th</sup> century, the third industrial revolution started, with electronics and information technology automating production. Globalisation and information technology led to trade in a borderless and electronic world. Input costs such as labour were reduced, which led to a growth of economies that could provide labour at a much lower cost than developed economies could. These developing economies grew without regard to the adverse impacts they were having on society and the environment. This is evidenced by the explosive growth over the last 50 years of the Chinese economy and the consequent present dangerous pollution levels in its industrial cities.

Likewise in India. With the increase of industry and motor vehicle ownership, the pollution of major Indian cities has become acute. On the 8<sup>th</sup> to the 11<sup>th</sup> of November 2017 the Delhi local government closed all the schools in the city because the levels of pollution were dangerous to health.<sup>10</sup> And in December

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<sup>10</sup> Heena Causar, 'Delhi Air Pollution: Government Orders Closure of All Schools till Sunday', *Hindustan Times* (online), 8 November 2017 <<https://www.hindustantimes.com/delhi-news/delhi-air-pollution-manish-sisodia-says-all-schools-to-remain-shut-till-sunday/story-kDdKDp37DLduCRQMiuHdUP.html>>.

2017 a cricket test match between India and Sri Lanka was stopped for the same reason.<sup>11</sup>

The development of information technology enabled research to be done much more quickly than had previously been possible and this research showed that, towards the end of the 20<sup>th</sup> century, major companies listed on some of the great stock exchanges in the world had only 30 per cent of their market capitalisation represented by figures in a balance sheet according to financial reporting standards. The focus on financial capital, maintained right through the 19<sup>th</sup> and 20<sup>th</sup> centuries, had changed. It had changed because of a realisation in the 21<sup>st</sup> century that natural assets were finite and that ecological overshoot had occurred — companies and individuals were using natural assets faster than nature was regenerating them. Development was unsustainable. Further, landfills had started toxifying underground water systems and Planet Earth was running out of suitable space for landfills.

The other 70 per cent of market capitalisation was made up of what became known as intangible assets. Asset owners and asset managers had realised that a company which had a long term strategy of value creation in a sustainable manner would probably survive and thrive in the changed world of the 21<sup>st</sup> century whereas a company that focused only on improving the bottom line at any cost would eventually fail. Further, society was starting to turn its face against companies that were having a negative impact on society or the environment. Wireless and mobile communication started galvanising civil society against poor corporate citizenship.

At the beginning of the 21<sup>st</sup> century I was asked to chair the United Nations Committee on Governance and Oversight and to redo the governance framework of the various agencies in the UN, which included the United Nations Environment Programme (UNEP) and the United Nations Conference on Trade and Development (UNCTAD). At about the same time, on the northeast coast of America, thought leaders in Boston were trying to work out how the boards of companies could report on the 70 per cent of value for which there was no accountability in an annual report which, in accordance with financial reporting standards, consisted only of the balance sheet, profit and loss statement and related notes. In Boston they started in earnest to draw up guidelines for sustainability reporting which led to the founding of the Global

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<sup>11</sup> 'Air Pollution Stops Play in Third India v Sri Lanka Test in Delhi', SkySports (online), 3 December 2017 <<https://www.skysports.com/cricket/news/12123/11154584/air-pollution-stops-play-in-third-india-v-sri-lanka-test-in-delhi>>.

Reporting Initiative (GRI) which moved its headquarters to Amsterdam. That is when I was asked to become its chairman.

Companies now started reporting in two silos, the annual financial statement and a sustainability report according to the then GRI Guidelines — now GRI Standards.

At the beginning of 2010 the International Federation of Accountants (IFAC) and the UN Community on Trade and Development called a meeting at the UN headquarters in Geneva. The invitees included, among others, the World Chairmen of the Big Four accounting firms,<sup>12</sup> the World Bank, the Institute of Internal Auditors, major asset owners, asset managers and regulators. The meeting was held under Chatham House Rules.<sup>13</sup>

At that meeting, the IFAC stated that it was clear that annual financial statements, as we had been doing them since the Great Depression of the 1930s, were critical but on their own not sufficient to discharge a board's duty to be accountable. I was able to say, as chairman of the GRI, that a sustainability report, without the numbers, was meaningless. But I went on to argue that to continue reporting in two silos was divorced from reality.

No company has ever operated on a basis that financial capital was in one building, human capital in another, natural capital in yet another, intellectual capital somewhere else, as with social and manufactured capital. There has always been a symphony of these sources of value creation because of their interconnection and interdependency, together with the relationships between the company and its stakeholders, such as its employees, suppliers, lenders of money, service providers, shareholders, and so forth. These sources of value creation and relationships have always been integrated.

His Royal Highness, Prince Charles, had in 2006 started the Accounting for Sustainability Trust (A4S) because he argued that the annual reports of companies in which the Royal Family invested had not reported on how their business models had impacted on society and the environment.

Sir Michael Peat, who was then the treasurer to the Royal Household met with me towards the end of 2009. This led to the historic meeting at St James' Palace, called by his Royal Highness Prince Charles, to which the great institutions of the world, the great regulators, the Big Four accounting firms, great asset

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<sup>12</sup> Ernst & Young, Deloitte & Touche, KPMG and PricewaterhouseCoopers.

<sup>13</sup> In other words, the information disclosed at the meeting was able to be reported by those present, but the source of the information was not to be identified.

owners, and asset managers were invited. During the discussion it was asked, ‘How does a board of directors discharge its duty of accountability to the incapacitated company that is so dependent on it if it doesn’t report on how the company is operating, namely on an integrated basis?’ The outcome was the formation of the International Integrated Reporting Council (IIRC) of which I became, and remain, the chairman. My deputy chairman, I am happy to say, is the Chancellor of Deakin University, John Stanhope. In addition, on the IIRC’s board we have a Deakin Fellow on integrated thinking and reporting, a former senior partner of KPMG Australia, Michael Bray.

In the IIRC Framework it was pointed out that, in a value-creation situation, there are inputs, and the major inputs can be listed under six types of capital, namely financial, manufactured, human, intellectual, natural and social capital, the last of which would include the relationship between the company and its stakeholders. A company should build these six types of capital into its business strategy in the resource-constrained world of the 21<sup>st</sup> century, and not merely focus on financial capital. The sustainability issues critical to the business of the company, such as the conservation of water to the brewer of beer, should be part of the company’s long term sustainable value-creation strategy. Under this framework the board would be dealing with the outcomes of the company’s business model, rather than leaving them to regulators and NGOs.

The biggest users of natural assets and the biggest polluters are both private and public companies. Companies have in previous centuries been acting lawfully pursuant to the shareholder-centric governance model prevailing at the time, but committing wrongs against society and the environment. ‘Lawful wrongs’ is an oxymoron, but directors were lawfully directing companies to maximise profit instead of focusing on the long term health of the company, as pointed out by Professors Joseph Bower and Lynn Paine of Harvard University.<sup>14</sup>

The outcomes-based approach of integrated reporting is to look at the value-creation chain from inputs into the company’s business to its outcomes — that is, its product or service and the effects on the three critical dimensions of sustainable development (the economy, society and the environment) that that product or service has when it goes out into society. This outcomes-based approach is now recognised in the Sustainable Development Goals of the UN of April 2015. In them the UN states that in order for companies? to achieve sustainable development by 2030, account has to be taken of the indivisible and integrated dimensions of the economy, society and the environment. The goal

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<sup>14</sup> Joseph L Bower and Lynn S Paine, ‘The Error at the Heart of Corporate Leadership’ (2017) 95(3) *Harvard Business Review* 50.

is to achieve this by 2030; otherwise, by the end of this century, life on Planet Earth may not be sustainable for those who come after us.

We have now entered the fourth industrial revolution based on digitisation, artificial intelligence, the internet of things, nano-technology, bio-technology and 3D printing. At the same time, we have diminishing natural assets and continuing population growth — 7.4 billion people at present, 9.3 billion by 2045 according to the extrapolation done by the UN. It is clear that it is no longer an option to carry on business as usual. Society, with radical transparency at its fingertips through social media, no longer accepts these lawful wrongs against humanity committed by a company. It wants the collective minds of boards to act in the best interests of these incapacitated artificial persons which society created and of which society is the licensor, so that they have positive impacts on the economy, society and the environment.

A major study has been done by the Boston Consulting Group entitled *Total Societal Impact: A New Lens for Strategy*. Its authors report: ‘For decades, most companies have oriented their strategies toward maximizing total shareholder return (TSR).’<sup>15</sup>

Now, however, corporate leaders are rethinking the role of business in society. Investors are increasingly focusing on companies’ social and environmental practices as evidence mounts that performance in those areas affects returns over the long term. Standards are being developed for which environmental, social, and governance (commonly referred to as ESG) topics are considered financially material by industry, and data on company performance in these areas is becoming more available and reliable, increasing transparency and drawing more scrutiny from investors and others.

The great companies that will survive and thrive into the 21<sup>st</sup> century are those which have their boards applying their collective minds to the fact that the corporate tools of yesterday can no longer be used today, that the mindset of the board has to change to perceive the business as an integrated and interactive whole, hoping to achieve positive outcomes in the three dimensions of the economy, society and the environment. Companies have to have a business strategy which results in long term value creation in a sustainable manner. Every company should address, at the end of each financial year, the positive

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<sup>15</sup> Douglas Beal et al, *Total Societal Impact: A New Lens for Strategy* (25 October 2017) Boston Consulting Group <<https://www.bcg.com/publications/2017/total-societal-impact-new-lens-strategy.aspx>>.

and negative impacts of its money-making strategies on the economy, society and the environment.

Good corporate citizenship demands that a board should develop strategy to enhance its positive impacts, and eradicate or ameliorate its negative impacts, on the three critical dimensions. In this way the company will be creating holistic value for society. By focusing on the financial only, a company may well be destroying value.

Good corporate citizenship is consistent with human rights. Poor corporate citizenship is inconsistent with human rights.

In July 2000 the United Nations launched the ten principles of its *Global Compact*.<sup>16</sup> It was based on the unprecedented rise in partnerships between business, civil society, governments and the United Nations, leading to the Sustainable Development Goals of April 2015. The UN stated that business has to be a part of a solution to the global challenges of people, planet and profit.

The *Global Compact* contains ten principles, by following which a company can exhibit good corporate citizenship. The ten principles are derived from the *Universal Declaration of Human Rights*, the International Labour Organisation's *Declaration on Fundamental Principles and Rights*, the *Rio Declaration on Environment and Development* and the *UN Convention against Corruption*.

Principles One and Two state that businesses should support and respect the protection of internationally proclaimed human rights and make sure that they are not complicit in human rights abuses. Further, business should promote a greater environmental responsibility and encourage the development and diffusion of environmentally friendly technologies (Principles 7–9).

Human rights are defined by the United Nations as rights to which a person is inherently entitled simply because he or she is a human being, regardless of nation, location, language, religion or ethnic origin. They are based on the foundation that all human beings are born free and equal in dignity and rights. Everyone has the right to an environment adequate for his or her health and well-being.

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<sup>16</sup> See UN Procurement Division, *UN Global Compact* <<https://www.un.org/Depts/ptd/about-us/un-global-compact>>.

The consequences of companies not being good corporate citizens are too horrible to contemplate. There will be no sustainable development and the outrage of society at poor corporate citizenship will continue.

We are in the fourth industrial revolution. We are in the age of immediacy. Tomorrow is another day but it will be a day of radical transparency, when no company will be able to keep a secret in its corporate closet anymore. Boards will have to think on an integrated basis about the long term health of the company and, if they do so, they will be seen to be good corporate citizens in a world which is not what it used to be. Boards will no longer be able to continue to operate, quite lawfully, by trying to maximise profit while having a negative impact on society and the environment. That is poor corporate citizenship and it wrongs humanity.

And after all, there is not only a corporate necessity to do this. There is a moral duty to ensure that development is sustainable. We have to achieve sustainable development that meets the needs of the present, without compromising the ability of future generations, your children, your grandchildren, to meet their own needs. This is a primary ethical and economic imperative. While we recognise crimes against humanity, we also cannot afford to ignore lawful wrongs against humanity. There has to be a change from shareholder-centric governance models to company-centric models, models which focus on the long term health of the company.

Nelson Mandela is widely quoted as having said: ‘Action without vision is only passing time, vision without action is merely day dreaming, but vision with action can change the world.’

There is a revolutionary immensity in the vision of integrated thinking resulting in a business model which embraces sustainability issues pertinent to the business of the company, with positive impacts on the three dimensions of sustainable development. It has the outcome of dealing with lawful wrongs at source, in the boardroom, and meeting the outrage of the world at corporate profit being subsidised by society and the environment. That has been the free part of the free economy.

When Pacioli in the 15<sup>th</sup> century recorded the double entry bookkeeping system of the merchants of Venice he created the foundation of accountancy as we know it today. But that was purely financial. What is needed is a multi-capital approach to reflect value creation in a knowledge-based, natural resource-constrained world. Integrated thinking and integrated reporting match double entry bookkeeping for their global applicability and their resonance with the needs of today’s business and society.

Professor Robert G Eccles and George Serafeim from the Harvard Business School have, with Ioannis Ioannou of the London Business School, collected evidence which shows that high sustainability companies deliver significant positive financial performance over the long term, and that investors are beginning to value them more highly.<sup>17</sup> The American Consultancy, Arabesque, and the University of Oxford have reviewed academic literature on sustainability and corporate performance and found that 90 per cent of 200 studies analysed concluded that good environmental, social and governance standards lower the cost of capital; 88 per cent show that good environmental and social governance practices result in better operational performance; and 80 per cent show that stock price performance is positively correlated with good sustainability practices.<sup>18</sup> In short it has become good, hard-nosed business to ensure that a company's business model does not have adverse impacts on humanity.

As there is universal recognition of 'crimes against humanity', which connote conduct with wilful intent, there should be universal recognition of 'wrongs against humanity' committed by steering a company so as to maximise profit at any cost instead of to focus on its long term health and the long term interests of all its stakeholders. Such focus is our moral obligation to those who come after us. After all, we are transient caretakers of this planet and have a duty to leave it in a state that will not further prejudice the interests of those who come after us.

We must replace the negative outrages against society caused by corporate wrongs with positive corporate outcomes in all three of the dimensions of the economy, society and the environment. Then we will have good corporate citizenship, and humanity will have a right to clean water, clean air and arable land, in short the right to life.

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<sup>17</sup> Robert G Eccles, Ioannis Ioannou and George Serafeim and, 'The Impact of Corporate Sustainability on Organizational Processes and Performance' (2014) 60(11) *Management Science* 2835.

<sup>18</sup> Gordon L Clark, Andreas Feiner and Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance*, March 2015, 48 <[https://arabesque.com/research/From\\_the\\_stockholder\\_to\\_the\\_stakeholder\\_web.pdf](https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf)>.