

Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness

David Hess*

I. INTRODUCTION	42
II. REFLEXIVE LAW	48
III. CORPORATE SOCIAL RESPONSIBILITY AND RESPONSIVENESS	51
A. <i>Corporate Social Responsibility</i>	52
B. <i>Corporate Social Responsiveness</i>	54
C. <i>Critique of Social Responsiveness and the Idea of Social Contracts</i>	55
IV. SOCIAL RESPONSIVENESS: THE NEED FOR A REFLEXIVE LAW APPROACH	58
V. SOCIAL REPORTING	63
A. <i>Implementing Social Reporting Legislation</i>	64
B. <i>Social Reporting Requirements</i>	66
1. <i>Mandatory</i>	66
2. <i>Social Reporting Procedures and Policies</i>	67
3. <i>Stakeholder-Oriented</i>	68
4. <i>Verification</i>	70
5. <i>Annual, Publicly Disclosed Social Report</i>	71
VI. CORPORATE SOCIAL REPORTS: TWO EXAMPLES	72
A. <i>The Body Shop</i>	72
B. <i>Ben & Jerry's Homemade, Inc.</i>	77
VII. ARGUMENTS FOR AND AGAINST SOCIAL REPORT LEGISLATION	80
A. <i>Arguments Against Social Report Legislation</i>	80
B. <i>The Benefits of Social Reports as Reflexive Law</i>	81
VIII. CONCLUSION	84

*If people cannot accurately know their world, how can they be expected to act
wisely in it.¹*

*If corporations were required to disclose information about their actions affecting
[stakeholders], then pressure would mount to justify those acts; and justifying one's acts,
most ethicists would grant, is the first step toward improving one's behavior.²*

* The author received his J.D. from the University of Iowa in 1995, and is currently a doctoral candidate at the Wharton School of the University of Pennsylvania. I am especially grateful to Thomas W. Dunfee for his guidance and assistance on this research. This research also benefited from the advice and comments of Thomas Donaldson, Eric W. Orts, and Randall Thomas. The positions expressed in this paper do not necessarily reflect those of any of the people listed above and any errors are mine alone.

1. Quote attributed to Walter Lippman, 20th century political commentator.

2. THOMAS DONALDSON, CORPORATIONS & MORALITY 204 (1982).

I. INTRODUCTION

We will soon be upon the twenty-fifth anniversary of the publication of Christopher D. Stone's *Where the Law Ends: The Social Control of Corporate Behavior*.³ This book cogently presents the many problems traditional legal mechanisms have in controlling the irresponsible behavior of corporations.⁴ The problems Stone identified, however, still have not been adequately addressed by our current regulatory system.⁵ Before we can correct this regulatory failure, the debate over how to control corporate behavior must move beyond the dichotomous choice between omnipresent state regulation and a *laissez-faire* system.⁶ As shown by arguments for "responsive regulation" and "collaborative governance," among others,⁷ there is a need for, and an increasing movement towards, being more experimental and flexible in finding what regulatory system works best to achieve the desired outcome.

This Article argues for the use of a reflexive law approach to govern the behavior of corporations. Recent advances in legal theory have developed the idea of reflexive law as a viable alternative to the traditional choices of regulation.⁸ Professor Eric Orts describes reflexive law as a regulatory system that recognizes the limited ability of the law in a complex society to direct social change in an effective manner.⁹ Instead of trying to suppress the complexity and diversity in society through extensive regulation, reflexive

3. CHRISTOPHER D. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* (1975).

4. In this context, irresponsible behavior includes not only violations of the law but also a company's behavior with respect to such matters as pollution, human rights, and product safety. Collectively, a corporation's performance on these non-financial matters may be called its "social performance." For a further discussion of this issue, see *infra* Parts III.A and III.B (discussing the ideas of corporate social responsibility and corporate social responsiveness).

5. See *infra* Part IV (presenting the problems of "substantive" law in producing socially responsible corporations).

6. See IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 3 (1992) ("Good policy analysis is not about choosing between the free market and government regulation. Nor is it simply deciding what the law should proscribe.").

7. See generally *id.* (presenting the idea of "responsive regulation," which generally means that the best regulatory strategy will be dependent on the particular industry context); Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997) (arguing for the use of a "mixed" liability regime when determining whether to hold a corporation liable for the wrongdoings of its agents); Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998) (arguing for a more decentralized regulatory system and using local knowledge to solve local problems); Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1 (1997) (arguing for the sharing of regulatory responsibility between public and private interests); Douglas C. Michael, *Cooperative Implementation of Federal Regulations*, 13 YALE J. ON REG. 535 (1996) (arguing for more involvement of regulated entities in implementing federal regulations).

8. On reflexive law, see generally REFLEXIVE LABOUR LAW: STUDIES IN INDUSTRIAL RELATIONS AND EMPLOYMENT REGULATION (Ralf Rogowski & Ton Wilthagen eds., 1994) [hereinafter REFLEXIVE LABOUR LAW]; Eric W. Orts, *Reflexive Environmental Law*, 89 NW. U. L. REV. 1227 (1995); Gunther Teubner, *Autopoiesis in Law and Society: A Rejoinder to Blankenburg*, 18 L. & SOC'Y REV. 291 (1984) [hereinafter Teubner, *Autopoiesis*]; Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 L. & SOC'Y REV. 239 (1983) [hereinafter Teubner, *Reflexive Elements*].

9. Eric W. Orts, *A Reflexive Model of Environmental Regulation*, 5 BUS. ETHICS Q. 779, 780 (1995).

law aims to guide behavior and promote self-regulation.¹⁰ The law is "reflexive" in that it encourages corporations to constantly re-examine their practices and reform those practices based on the most current information.¹¹

To control corporate behavior, the necessary reflexive law approach is social accounting, auditing, and reporting, collectively referred to here as social reporting. A social report is, in brief, "[a] means of assessing the social impact and ethical behavior of an organization in relation to its aims and those of its stakeholders. Stakeholders include all individuals and groups who are affected by, or can affect, the organization."¹² In many ways, a social report is similar to a corporate financial audit, but concerns a company's social performance. However, disclosure is only a part of the story—though a very important part—and not the whole story. A reflexive law approach to social reporting focuses on institutionalizing responsible decision-making within an organization and thereby sharing the regulation of corporate behavior with the regulated entity.

An issue avoided until now is why should government regulations require corporations to care about their social performance? The simple answer to this question is that society, and in particular the marketplace, expects and demands it.¹³ A recent survey found that ninety-five percent of Americans disagreed with the view that the only responsibility of business is to increase profits.¹⁴ Other evidence that society cares about a company's social performance is abundant. In any bookstore you can find books on the best companies to work for in America¹⁵ and guides to socially responsible shopping.¹⁶ Popular magazines and newspapers regularly report on socially responsible and

10. *Id.* By "self-regulation" I do not mean a *laissez-faire* system, as the legislation proposed here will still require the regulated firm to comply with certain requirements. What I do mean is a movement away from legislation that takes full responsibility for the outcomes of a firm's behavior.

11. *Id.*

12. Chris Nelder, *Social Assessment*, BWZINE: THE ONLINE BETTER WORLD MAGAZINE (Apr./May 1996) <<http://www.betterworld.com/BWZ/9604/cover1-1.htm>> (quoting Dr. Simon Zadek of the New Economic Foundation, London).

13. Simon Zadek et al., *Why Count Social Performance?*, in BUILDING CORPORATE ACCOUNTABILITY 12, 27 (Simon Zadek et al. eds., 1997) ("The views either that social and ethical performance can remain private or that the public do not care about what happens beyond their backyards have proved misguided.").

14. Keith H. Hammonds, *Writing a New Social Contract*, BUS. WK., Mar. 11, 1996, at 60. This Business Week/Harris Poll asked 1004 adults if they believed that corporations' only role is to make money. *Id.* Ninety-five percent of the respondents stated that they did not agree with that statement. *Id.* This is strong support for the rejection of Milton Friedman's classic view of corporate social responsibility. Friedman's basic argument is: "[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, reprinted in ETHICAL ISSUES IN BUSINESS: A PHILOSOPHICAL APPROACH 217, 223 (Thomas Donaldson & Patricia Werhane eds., 3d ed. 1988).

15. See generally ROBERT LEVERING & MILTON MOSKOWITZ, THE 100 BEST COMPANIES TO WORK FOR IN AMERICA (1994); see also STEVEN D. LYDENBERG ET AL., RATING AMERICA'S CORPORATE CONSCIENCE (1986).

16. See generally BENJAMIN HOLLISTER ET AL., SHOPPING FOR A BETTER WORLD: THE QUICK AND EASY GUIDE TO ALL YOUR SOCIALLY RESPONSIBLE SHOPPING (1994).

irresponsible corporations.¹⁷ Shareholders frequently submit proposals on a wide variety of social issues, and recent rule changes by the SEC have broadened the range of proposals that shareholders may submit.¹⁸ Perhaps most striking is the success of "socially screened" investment portfolios.¹⁹ Approximately nine percent of all professionally managed investments in the United States (\$1.2 trillion) are screened for certain social factors.²⁰

Society has also shown its concern for corporate behavior through numerous consumer boycotts of certain companies' products and services due to those companies' records on matters such as the environment, animal rights, and human rights.²¹ Nike and

17. See *infra* note 22 (discussing negative publicity Nike received for allegedly permitting the use of child labor in its Asian contractors' manufacturing plants); see also, *infra* note 191 (discussing the negative publicity Shell Oil received surrounding its attempted dumping of an abandoned oil rig).

18. See 17 C.F.R. § 240.14a-8(c)(7) (1997), as amended by 63 Fed. Reg. 28106, 29107-9 (1998). For a discussion of the recent rules changes, see Merrill B. Stone & Devika Kewalramani, *Final Shareholder Proposal Rules Fall Short of Reform*, N.Y. L.J., June 22, 1998, at B9.

19. See generally AMY L. DOMINI & PETER D. KINDER, *ETHICAL INVESTING* (1986) (providing one of the first comprehensive discussions of investing based on ethical criteria); Sandra Block, *Investors Can Satisfy Wallet, Conscience*, USA TODAY, July 2, 1997, at 3B (stating that socially screened funds commonly avoid firms involved in the areas of alcohol, tobacco, gambling, nuclear power, defense manufacturing, and firms that are considered polluters); Laura Castaneda, *Putting Your Money Where Your Morals Are*, S.F. CHRON., Dec. 30, 1996, at D1 (noting that some socially screened funds seek to invest in companies that are considered to be meeting progressive ideals, such as promoting women and minorities to high positions within the organization); Dee Gill, *Want to Put Your Money Where Your Conscience Is?*, BUS. WK., Sept. 8, 1997, at 134 (discussing the availability of funds to screen out companies based on whatever values the investor wishes to further, ranging from fundamentalist Christianity to gay rights); *Good Works—And Great Profits*, BUS. WK., Feb. 16, 1998, at 8 (noting that the Domini 400 Social Index, one of the most famous socially screened funds, outperformed the Standard & Poor's 500-stock index by approximately 15% in 1997).

20. *Business Bulletin*, WALL ST. J., Feb. 4, 1999, at A1. From 1995 to 1997, the assets in such portfolios grew by \$529 billion. *Id.* According to David Vidal of the Conference Board, New York, a leading business membership and research organization, this phenomenon is a long-term trend and not a reflection of a bull market. *Id.*

21. A 1994 survey of 1037 Americans found that 47% of consumers would be "much more" likely to buy from a socially responsible company when choosing between equal products (88% were "somewhat more likely"). Robert L. Gildea, *Consumer Survey Confirms Corporate Social Action Affects Buying Decisions*, 39 PUB. REL. Q. 20 (Dec. 1994). In addition to rewarding responsible companies, 57% of consumers indicated they would be "much less likely" to buy from a company that was not socially responsible (92% stated they were at least "somewhat less likely"). *Id.* Likewise, a survey of 30,000 food retail customers in Great Britain found that 35% of the customers had boycotted a product due to such concerns, and 60% stated that they would boycott a shop or product due to these issues. Simon Zadek, *Balancing Performance, Ethics, and Accountability*, 17 J. BUS. ETHICS 1421, 1423 (1998); see also Zadek et al., *supra* note 13, at 27.

Under the current regulatory system, however, there are doubts about the ability of consumer preferences (or the "invisible hand" of the market) to create socially responsible corporations. Christopher Stone notes four unwarranted assumptions about consumers' ability to boycott or reward corporations based on their social performance:

(1) that the persons who are going to withdraw patronage know *the fact* that they are being 'injured' . . . (2) that they know *where* to apply pressure of some sort; (3) that they are in a *position* to apply pressure of some sort; and (4) that their pressure will be *translated* into warranted changes in the institution's behavior.

STONE, *supra* note 3, at 89. These unwarranted assumptions call into question the ability of consumers to direct positive social change in corporations, in many, if not the vast majority of situations. The social reports discussed in this article hope to address these problems.

others have recently come under enormous pressure to rethink their treatment of labor in several Asian countries.²² Apparently, these practices have been going on for years, so why must they now reconsider their business practices? The simple answer again is that society has demanded it. Influential segments of society have decided that such practices are not socially responsible and have placed pressure on businesses to change these practices.²³

But what does it mean for a corporation to be socially responsible? A common view finds that a corporation that meets the requirements of the law is socially responsible.²⁴ However, business ethics and legal scholars have long recognized the limits of the law in stating society's important values and improving the social performance of corporations.²⁵ In light of this recognition, business ethics theorists have considered what it means for a corporation to be socially responsible in all its activities, without necessarily relying on legal concepts.²⁶ However, this debate had much difficulty

22. Nike came under pressure to rethink the working conditions of its plants in Vietnam after an internal audit by the accounting firm Ernst and Young was leaked to the public by the Transnational Resource and Action Centre. William Lewis, *Nike Under Fire on Conditions in Vietnam*, FIN. TIMES, Nov. 10, 1997, at 5. The report found that the employees of the plant that had contracted with Nike were exposed to carcinogens, had respiratory problems, and were forced to work 65 hours a week for only \$10 per week. Steven Greenhouse, *Nike Shoe Plant in Vietnam Is Called Unsafe for Workers*, N.Y. TIMES, Nov. 8, 1997, at A1. Prior to this report, Nike had been accused of operating sweatshops in Indonesia, but steadfastly denied these allegations. See Del Jones, *Critics Tie Sweatshop Sneakers to 'Air' Jordan*, USA TODAY, June 6, 1996, at 1B (quoting a Nike spokesperson's statement that "It's better to have companies like Nike with a brand image at stake operating in these countries to assure that abuses don't occur."); *Protestors Rally for Nike Workers in Asia*, CHI. TRIB., July 16, 1996, at 9 (reporting that in response to a demonstration in Chicago demanding better working conditions for laborers in Indonesia, Nike claimed that its contract workers made double the local minimum wage).

In April 1998, Nike was sued in California for allegedly misleading the public about the treatment of workers in Vietnam, China, and Indonesia, which the plaintiffs claimed was in violation of California's consumer laws. Aurelio Rojas, *Nike Faces Suit Over Factory Conditions: Firm Accused of Lying About Asian Workers*, S.F. CHRON., Apr. 21, 1998, at A3. The suit alleges that Nike misled its consumers by claiming in advertisements and other public relations material that it protects the employees of its foreign subcontractors. *Id.*

In response to these public pressures, in May 1998, Nike's Chief Executive, Phillip Knight, announced that Nike would work to prohibit the use of underage workers by its overseas manufacturers and to ensure that these plants meet the health and safety standards of the United States. John H. Cushman, Jr., *Nike Pledges to End Child Labor and Apply U.S. Rules Abroad*, N.Y. TIMES, May 13, 1998, at D1. Nike also agreed to allow human rights and labor interest groups to inspect its Asian factories. *Id.* Acknowledging the public's opinion of Nike, Knight stated, "The Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse . . . I truly believe that the American consumer does not want to buy products made in abusive conditions." *Id.*

23. For an interesting discussion of how individuals acting on moral preferences in the commercial world create a "market of moral inputs and outputs," see Thomas W. Dunfee, *The Marketplace of Morality: First Steps Toward a Theory of Moral Choice*, 8 BUS. ETHICS Q. 127 (1998).

24. See Thomas W. Dunfee, *On the Synergistic, Interdependent Relationship of Business and Law*, 34 AM. BUS. L.J. 317, 319 (1996). Two commonly held, but mistaken, views are: "(1) that law and ethics occupy entirely separate realms, not to be confused or intermingled; and (2) that there is a perfect congruence between law ethics, so that if something is determined to be legal, it may be considered ethical." *Id.*

25. Edwin M. Epstein, *The Corporate Social Policy Process and the Process of Corporate Governance*, 25 AM. BUS. L.J. 361, 367 (1987); see also *infra* Part IV (discussing the many problems the current regulatory system has in improving corporations' social performance).

26. Epstein, *supra* note 25, at 374.

producing a single, universally applicable definition of social responsibility.²⁷ Furthermore, society's expectation of what is "ethical" or "responsible" changes over time and can also vary greatly depending upon the circumstances.²⁸

In light of this "value pluralism,"²⁹ the legislatively required social report proposed here is a way in which the law can follow the reflexive law approach and meaningfully guide corporations to be responsive to the public's expectations of what it means to be socially responsible. Corporations conforming to societal expectations and norms of proper behavior (within certain bounds) constitutes the essence of social responsibility.³⁰ Rather than attempting to determine how a socially responsible corporation should behave and legislatively requiring all corporations to behave in such a manner, a mandatory social report takes the form of reflexive law. To induce appropriate corporate behavior, the social report would be disclosed to the public.³¹ The value of the social report is not only in its creation of social transparency, but in achieving the reflexive law goal of institutionalizing responsible decision-making and creative thinking in corporations.

Thus, as a reflexive law, a social report would not mandate that certain predetermined outcomes be reached, but would instead require a corporation to reflect on how its practices impact society and to open up dialogues with the relevant stakeholders. Although this process may not at first glance please those who would prefer to directly regulate corporate behavior wherever possible, a social report will create a regulatory system more in line with, and responsive to, any particular corporation's unique situation, while also reflecting society's current expectations. Professor Thomas Dunfee has warned that "[l]aw without reference to ethics and community moral values is in danger

27. *Id.*; ARCHIE B. CARROLL, BUSINESS AND SOCIETY: MANAGING CORPORATE SOCIAL PERFORMANCE 29, 32-33 (1983); WILLIAM C. FREDERICK, VALUES, NATURE, AND CULTURE IN THE AMERICAN CORPORATION 217-18 (1995). For example, Dow Votaw stated:

The term [social responsibility] is a brilliant one; it means something, but not always the same thing, to everybody. To some it conveys the idea of legal responsibility or liability; to others it means socially responsible *behavior* in an ethical sense; to still others, the meaning transmitted is that of "responsible for," in a causal mode; many simply equate it with a charitable contribution.

Dow Votaw, *Genius Becomes Rare*, in THE CORPORATE DILEMMA: TRADITIONAL VALUES VERSUS CONTEMPORARY PROBLEMS 11, 11 (Dow Votaw et al. eds., 1973).

28. Epstein, *supra* note 25, at 368; *see also* SECURITIES AND EXCHANGE COMMISSION, STAFF REPORT ON CORPORATE ACCOUNTABILITY 233 & 233 n.17 (1980) [hereinafter STAFF REPORT] (noting the yearly fluctuations in the topics of shareholder proposals).

29. "Value pluralism and related value tensions are . . . long-standing characteristics of the American civic culture in which such key, and sometimes conflicting, values as success, freedom, justice, equity, efficiency, contractualism, communitarianism, utilitarianism, and individualism, together with deeply-ingrained notions of personal and property rights, influence our concepts of ethical and responsible behavior." Epstein, *supra* note 25, at 368.

30. *See infra* Part III.C (discussing Integrative Social Contracts Theory). A simple test any manager or employee can generally use to see if they are conforming to societal norms may be termed the "front page" test. When considering a decision that raises ethical issues, the decision-maker can imagine the various possible reactions from the public if that decision was published on the front page of the local newspaper (or perhaps an international newspaper for multinational corporations). *See* THOMAS DONALDSON & THOMAS W. DUNFEE, TIES THAT BIND: A SOCIAL CONTRACTS APPROACH TO BUSINESS ETHICS 204 (1999).

31. This is similar to, and builds on, the disclosure theme in federal securities laws. *See infra* notes 203-204 and accompanying text.

of becoming disconnected from the public will."³² Regulating corporate social responsibility using a social report avoids risking such a disconnection by requiring an interchange between the corporation and its stakeholders when conducting the social report, and by permitting meaningful public scrutiny. Furthermore, each corporation would only be held to the expectations and agreed upon norms for the communities in which it operates (e.g., its industry, geographic region, or any other relevant aspect of the transaction involved).³³

Social reports are not a new idea,³⁴ but we must seriously consider whether it is now time to legislate corporate social reporting.³⁵ The ability of social reporting to work effectively can be seen in the recent success of, and improvements in, non-mandatory environmental auditing.³⁶ Moreover, in Europe, several institutions have been established to advance the field of social accounting, auditing, and reporting.³⁷ As discussed above, society clearly has a deep concern about a corporation's social performance. In addition, the business ethics literature recognizes the importance of society's expectations and norms of proper behavior in determining what is appropriate corporate behavior.³⁸ These factors demonstrate the need for building on the success of environmental audits and expanding such audits to include all aspects of a firm's social performance. Furthermore, these factors, as well as the problems the current regulatory system has with improving a

32. Dunfee, *supra* note 24, at 319.

33. This is not to say that an industry is entirely free to establish its own norms of proper behavior, which can have less than desirable results. For example, in *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978), the engineers association established a code of ethics which stated that it was inappropriate in their industry to compete on price. *Id.* at 683 n.3. This code of ethics failed to recognize that the members of the industry must act in accordance with the agreed upon norms of all communities affected by the transaction and the norms of the wider community. For further clarification, see *infra* Part III.C (discussing business' social contract with the various communities in society).

34. See generally CLARK C. ABT, *THE SOCIAL AUDIT FOR MANAGEMENT* (1977); RAYMOND BAUER & DAN H. FENN, *THE CORPORATE SOCIAL AUDIT* (1972); DAVID BLAKE ET AL., *SOCIAL AUDITING* (1976); RALPH ESTES, *CORPORATE SOCIAL ACCOUNTING* (1976). See *infra* Part V for a brief discussion on the history of social reporting.

35. Cf. Meinolf Dierkes & Ariane Berthoin Antal, *Whither Corporate Social Reporting: Is It Time to Legislate?*, 28 CAL. MGMT. REV. 106, 119 (1986) (asking this question in 1986 and answering affirmatively).

36. For the history and legal background of environmental auditing, see Eric W. Orts & Paula C. Murray, *Environmental Disclosure and Evidentiary Privilege*, 1997 U. ILL. L. REV. 1, 8-21 (1997). The European Union has established a voluntary environmental audit scheme called the European Eco-Management and Audit Scheme (EMAS). See Orts, *supra* note 8, at 1287-1311 (providing a description of the EMAS regulations). A wide variety of corporations, including Coca-Cola, Mobil, and General Motors, have agreed to follow the Coalition for Environmentally Responsible Economies (CERES) principles, a code of conduct concerning behavior on environmental matters that includes the requirement of the public disclosure of an environmental report. See *The CERES Principles* (visited Sept. 9, 1999) <<http://www.ceres.org/about/principles.html>>. The CERES principles are a revision of the Valdez Principles by the CERES. *Id.*

37. The European institutions devoted to the study of social and environmental accounting, auditing, and reporting include: the Institute of Social and Ethical Accountability in London; the Centre for Environmental and Social Accountancy Research at the University of Dundee; the New Economics Foundation in London; and the European Institute for Business Ethics at Nijenrode University. For the addresses of these organizations, see Annex, *Key Contact Names and Addresses*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 218-19. In addition, much work is being done at the Copenhagen Business School under the direction of Professor Peter Pruzan. *Id.*

38. See *infra* Parts III.B-C (discussing the developments in the business ethics literature on stakeholder theory and social contracts theory).

corporation's social performance,³⁹ indicate the need for making social reports mandatory under a reflexive law approach to achieving corporate social responsiveness.

This Article will proceed by first discussing the emergence of reflexive law to meet the demands of increasing societal complexity.⁴⁰ The next section shifts to a discussion of what the term "corporate social responsiveness" means.⁴¹ This Article will also introduce Integrative Social Contracts Theory as a foundation for determining the parameters of social responsiveness.⁴² Next, this Article argues that substantive law is unable to produce socially responsive corporate behavior and that a reflexive law approach is necessary.⁴³ The following section presents social reports as the reflexive law approach that will achieve the objective of social responsiveness.⁴⁴ To provide a better understanding of the social reporting process, this Article then provides two examples of companies currently conducting social reports.⁴⁵ Finally, this Article concludes by considering the potential arguments against such legislation and then discusses the benefits of social reporting as a reflexive law approach.⁴⁶

II. REFLEXIVE LAW

In his seminal article on reflexive law, Gunther Teubner examines the evolution of law through three "types": formal, substantive, and reflexive.⁴⁷ First, "formal" law develops with an emphasis on the creation and application of a universal body of rules.⁴⁸ Within this set of rules, private actors are free to pursue their own interests and rely on private ordering.⁴⁹ Over time, state regulation increases and "substantive" law becomes more prominent.⁵⁰ Substantive law emphasizes "purposive, goal-oriented intervention" by the state.⁵¹ Rather than permitting autonomy, as in formal law, substantive law focuses on the achievement of predetermined outcomes through regulation and standards.⁵²

Teubner's example of contract law illustrates the difference between these two types of laws. Under formal law, if there is a contractual dispute, the law will only look to see if certain elements establishing a valid contract have been met, such as whether there was mutual assent (offer and acceptance).⁵³ Under substantive law, however, the law may

39. See *infra* Part IV (showing the problems with the current "substantive law" approach in the area of corporate social performance).

40. See *infra* Part II.

41. See *infra* Part III.

42. See *infra* Part III.C.

43. See *infra* Part IV.

44. See *infra* Part V.

45. See *infra* Part VI.

46. See *infra* Part VII.

47. Teubner, *Reflexive Elements*, *supra* note 8, at 252-57.

48. *Id.* at 252-53.

49. *Id.* at 252. Teubner states that the "justification for formal law lies in its contributions to individualism and autonomy." *Id.*

50. *Id.* at 253.

51. Teubner, *Reflexive Elements*, *supra* note 8, at 240.

52. *Id.* at 253-54.

53. *Id.* at 255.

actually alter the terms of the parties' contract to ensure that certain socially-desired outcomes are achieved.⁵⁴

Extensive reliance on substantive laws creates what Teubner has dubbed the "Crisis of the Interventionist State."⁵⁵ This crisis results from substantive law's inability to meet the demands placed on it by an increasingly "differentiated" society.⁵⁶ Here, Teubner relies on a modern sociological systems theory (primarily the works of Niklas Luhmann).⁵⁷ In systems theory, as society develops and becomes increasingly more complex, it separates into distinct subsystems based on function—such as science, religion, family life, education, politics, law, and other systems⁵⁸—that each have their own world view and discourse.⁵⁹ Due to these subsystems' separate and distinctive rationality, society is no longer "stratified" (*i.e.*, hierarchically ordered between the "rulers and the ruled"),⁶⁰ but is "functionally differentiated."⁶¹ In a functionally differentiated society, the various subsystems are relatively autonomous.⁶² The law is a function subsystem on the same plane as, and independent from, the economic, political, or science function subsystems, for example.⁶³ This results in the law being "decentered" from its place in society; it is no longer the central institution for integrating all of society's subsystems.⁶⁴

Two general problems arise from the extensive use of substantive law in a complex, functionally differentiated society that cause the law to become decentered: cognitive

54. *Id.* at 255-56.

55. *Id.* at 267.

56. Orts, *supra* note 8, at 1260.

57. Teubner, *Reflexive Elements*, *supra* note 8, at 270-73.

58. NIKLAS LUHMANN, *THE DIFFERENTIATION OF SOCIETY* xii, 104 & 236-37 (1982); Ton Wilthagen, *Reflexive Rationality in the Regulation of Occupational Safety and Health*, in *REFLEXIVE LABOUR LAW*, *supra* note 8, at 345, 347; Orts, *supra* note 8, at 1260.

59. Rafi Rogowski & Ton Wilthagen, *Reflexive Labour Law: An Introduction*, in *REFLEXIVE LABOUR LAW*, *supra* note 8, at 3, 8.

60. Orts, *supra* note 8, at 1260.

61. In a functionally differentiated society, "[s]ince all necessary functions have to be fulfilled and are interdependent, society cannot concede absolute primacy to any one of them." LUHMANN, *supra* note 58, at 236. For a list of the main forms of differentiation discussed by Luhmann, see *id.* at 364 n.2.

62. Luhmann argues that this autonomy is necessary and unavoidable. Niklas Luhmann, *The Self-Reproduction of Law and Its Limits*, in *AUTOPOIETIC LAW: A NEW APPROACH TO LAW AND SOCIETY* 111, 112-13 (Gunther Teubner ed., 1988) [hereinafter *Luhmann, Self-Reproduction*]. Each subsystem has a function in society, and therefore the autonomy of subsystems is required "because no other [sub]system can replace it with respect to its function." *Id.* at 112. Using the legal subsystem as an example, it is autonomous because while "[t]here may be political control of legislation . . . only the law can change the law. Only within the legal system can the change of legal norms be perceived as change of the law." *Id.* at 113. (For a complete discussion of the autonomy of the legal system, see LUHMANN, *supra* note 58, at 122-37). Even attempted substitutes for a subsystem are part of the subsystem as "functional equivalents." *Luhmann, Self-Reproduction*, *supra*, at 120. When society is differentiated based on function, "no functional subsystem is able to solve the core problems of another subsystem," or act as a substitute in its place. *Id.* at 120-21 (emphasis removed). This is not to say that there is not a high degree of interdependence between subsystems, but autonomy is necessary to avoid the situation where "the operations of one subsystem produce unsolvable problems in another subsystem." LUHMANN, *supra* note 58, at xvi (quoting NIKLAS LUHMANN, *FUNKTION DER RELIGION* 242 (1977)).

63. Rogowski & Wilthagen, *supra* note 59, at 6.

64. Orts, *supra* note 8, at 1260-61.

limitation and normative legitimacy.⁶⁵ Cognitive limitation refers to the problem of too much regulatory law, which Teubner has termed "juridification."⁶⁶ Cognitive limitation is reached when society becomes too complex for effective control by intervention.⁶⁷ Simply stated, "Legal and bureaucratic structures cannot incorporate models of social reality that are sufficiently rich to allow them to cope effectively with the crises of economic management."⁶⁸ Furthermore, attempting to completely regulate some problems with substantive law can result in a mass of laws beyond any individual's comprehension.⁶⁹

Normative legitimacy refers to the "separation of lawmaking from the democratic procedures that contributes to the legitimacy of the system."⁷⁰ With the proliferation of various substantive laws, legislators can become unable to competently coordinate and reconcile statutes that may affect the same regulated behavior, but in different ways. Furthermore, complex regulations often result in giving agencies greater discretion in enforcing and interpreting the law.⁷¹

In response to this "Crisis of the Interventionist State," reflexive law emerges. Similar to substantive law, reflexive law intervenes in social processes, "but it retreats from taking full responsibility for substantive outcomes."⁷² Reflexive law takes a middle ground between formal law and substantive law by creating "regulated autonomy."⁷³ On the one hand, reflexive law leaves private actors free to determine their own outcomes. On the other hand, reflexive law intervenes in social processes by establishing procedures that guide the actors' behavior.

In terms of Luhmann's systems theory discussed above, reflexive law aims to "structure and restructure semi-autonomous social systems, by shaping both their procedures of internal discourse and their methods of coordination with other social systems."⁷⁴ Reflexive law serves as the necessary integration mechanism for society, but instead of attempting this from the central, society level as substantive law does, reflexive law does it from a decentralized position at the subsystem level.⁷⁵ This permits societal

65. *Id.* at 1258-60. This is not to suggest that all substantive law is ineffective, but that it can be ineffective in many situations. For a further critique of the administrative state, see generally Freeman, *supra* note 7.

66. JURIDIFICATION OF SOCIAL SPHERES 3 (Gunther Teubner ed., 1987).

67. Orts, *supra* note 8, at 1258.

68. Teubner, *Reflexive Elements*, *supra* note 8, at 268.

69. Orts, *supra* note 8, at 1259. Orts notes that this is particularly problematic in the area of environmental regulation, where the texts of just seven of the major federal environmental statutes are collectively several thousand pages long. *Id.* at 1240.

70. *Id.* at 1258.

71. For example, with reference to informal rule-making, Freeman states:

Perhaps even more troubling is the appearance that agencies increasingly rely upon regulatory instruments, such as interpretive rules, policy statements, guidance documents, enforcement discretion, and even press releases, which do not require notice and comment, as a way of avoiding the relatively demanding procedural requirements of informal rule-making. Such practices threaten to further undermine the legitimacy of the rules produced by removing even the pretense of public access and participation.

Freeman, *supra* note 7, at 9-10.

72. Teubner, *Reflexive Elements*, *supra* note 8, at 254.

73. *Id.*

74. *Id.* at 255.

75. See Wilthagen, *supra* note 58, at 347.

integration, but without the loss of the advantages of a highly differentiated society.⁷⁶ Overall, the law recognizes its own limits as a functional subsystem attempting to regulate other subsystems, and accomplishes its integration function by encouraging reflexive processes in other subsystems.⁷⁷

Reflexive law is primarily procedural law, and therefore may be considered self-regulation. Instead of directly regulating behavior to reach predetermined outcomes, reflexive law attempts to influence decision-making and communication processes with required procedures. The final decision, however, remains with the private actors.⁷⁸ The goal is to encourage self-reflective processes within corporations regarding the impact of their actions on society.⁷⁹

Returning to Teubner's contracting example from above, we can see that reflexive law has a quite different approach to the issue than the other types of law. While formal law accepts prior distributions between the contracting parties, reflexive law attempts to structure the negotiation process so that bargaining power is equalized. While substantive law commands that certain favorable contractual outcomes be reached, reflexive law only puts in place procedures that will ensure that various interests and externalities are taken into account in the bargaining process.⁸⁰

The Article now turns to a discussion of what it means for a corporation to be socially responsible or responsive.

III. CORPORATE SOCIAL RESPONSIBILITY AND RESPONSIVENESS

Although some may argue that business can best serve society only by the pursuit of profits,⁸¹ "the idea that corporations have an obligation to be socially responsible is so widely held, even among business leaders themselves, that it may seem pointless to bring it into question."⁸² But what does it mean to be "socially responsible"? Scholars studying this question have found that the idea of social responsibility can be understood best if divided into two distinct concepts: corporate social *responsibility* and corporate social

76. Gunther Teubner, *Corporate Fiduciary Duties and Their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility*, in *CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES* 161-62 (Klaus Hopt & Gunther Teubner eds., 1985).

77. Simply stated, "social subsystems have to learn about their place in society and have to be brought to take account of their external effects on other systems." Wiltshagen, *supra* note 58, at 348. Luhman's social theory states that subsystems have three different orientations: "(1) towards the entire social system in terms of *function*; (2) towards other societal subsystems in terms of input and output *performances*; and (3) towards itself in terms of *reflexion*." Teubner, *Reflexive Elements*, *supra* note 8, at 272. There is an inherent tension between *function* and *performance* that can only be reconciled by "externally stimulated internal reflexion." Teubner, *supra* note 76, at 164. Thus, reflexion structures are the primary integration mechanisms. Teubner, *Reflexive Elements*, *supra* note 8, at 272.

78. Eric Bregman & Arthur Jacobson, *Environmental Performance Review: Self-Regulation in Environmental Law*, in *THE CONCEPT AND PRACTICE OF ECOLOGICAL SELF-ORGANIZATION* 211 (Gunther Teubner et al. eds., 1994).

79. See Orts, *supra* note 8, at 1231-32.

80. Teubner, *Reflexive Elements*, *supra* note 8, at 256.

81. See Friedman, *supra* note 14, at 223.

82. JOHN R. BOATRIGHT, *ETHICS AND THE CONDUCT OF BUSINESS* 390 (1993).

responsiveness.⁸³ An understanding of these concepts is vital to an understanding of what the reflexive law approach advocated here is trying to achieve.

A. Corporate Social Responsibility

Corporate social responsibility is the idea that "corporations have an obligation to work for social betterment."⁸⁴ Archie Carroll divided corporate obligations into categories of economic, legal, ethical, and discretionary responsibilities, based on society's various expectations of business.⁸⁵ A corporation has an economic responsibility to produce goods and services, provide well-paying jobs, and earn a profit to ensure its survival.⁸⁶ By fulfilling these obligations, the corporation is improving the economic well-being of society. Corporations also have legal responsibilities. These responsibilities come from legislatures, regulatory agencies, and the courts.⁸⁷ Such responsibilities can take many forms and can go to shareholders, customers, suppliers, employees, and others.

Corporate social responsibility also means meeting society's expectations of proper business conduct that is not necessarily codified (*i.e.*, ethical responsibilities).⁸⁸ For example, although corporations are not legally required to make charitable donations, many members of society expect such behavior from profitable corporations. In addition, as the law may lag behind social norms,⁸⁹ there are responsibilities that society expects corporations to fulfill that may soon be legal requirements. Finally, corporations have purely discretionary responsibilities "about which society has no clear-cut message for business."⁹⁰ For example, society may expect corporations to help with major social

83. William C. Frederick, *From CSRsub1 to CSRsub2: The Maturing of Business-and-Society Thought*, 33 BUS. & SOC'Y 150 (1994) [hereinafter Frederick, *Maturing*] (This paper was originally written in 1978 but not published. However, it was a very influential working paper throughout the business ethics community and was published in 1994 as a classic paper.); William C. Frederick, *Toward CSR3: Why Ethical Analysis is Indispensable and Unavoidable in Corporate Affairs*, 28 CAL. MGMT. REV. 126 (1986) [hereinafter Frederick, *Toward CSR3*]; see also Barry Mitnick, *Systematics and CSR: The Theory and Process of Normative Referencing*, 34 BUS. & SOC'Y 5 (1995).

84. Frederick, *Maturing*, *supra* note 83, at 151. For a brief history of corporate social responsibility see CARROLL, *supra* note 27, at 30-32.

85. CARROLL, *supra* note 27, at 34-35; see also Archie B. Carroll, *A Three-Dimensional Conceptual Model of Corporate Social Performance*, 4 ACAD. MGMT. REV. 497 (1979); BOATRIGHT, *supra* note 82, at 386-87.

86. BOATRIGHT, *supra* note 82, at 386. Peter Drucker states:

Economic performance is the *first* responsibility of business. A business that does not show a profit at least equal to its cost of capital is socially irresponsible. It wastes society's resources. Economic performance is the basis; without it, a business cannot discharge any other responsibilities, cannot be a good employer, a good citizen, a good neighbor. But economic performance is not the sole responsibility of business.

PETER F. DRUCKER, *POST-CAPITALIST SOCIETY* 101 (1994).

87. BOATRIGHT, *supra* note 82, at 386.

88. *Id.* at 386-87 (presenting the arguments of Archie B. Carroll).

89. See *infra* text accompanying note 136.

90. Carroll, *supra* note 85, at 500.

problems, such as urban blight, due to their "considerable resources and skills,"⁹¹ but society does not have any clear expectations of how corporations should go about doing this.

The diversity of the situations to which social responsibility can apply led to what became the conventional wisdom in the 1970s to scholars in this area: that it is impossible to develop an operational definition of social responsibility that is universally applicable.⁹² Due to this problem, scholars shifted the debate to focus more on specific issues of responsibility, such as conducting business in South Africa or affirmative action policies.⁹³

Christopher Stone has presented a different approach to understanding what it means for a corporation to be socially responsible by first considering what it means for a person to be socially responsible.⁹⁴ A responsible person has an obligation to obey the law, but there is also a cognitive process aspect to responsibility.⁹⁵ First, a responsible person does not act on impulse to satisfy initial desires.⁹⁶ For example, people should not vent their rage by impulsively swinging punches at anyone nearby.⁹⁷ Second, a responsible person also "takes in the morally salient features of her environment,"⁹⁸ such as other persons and the harms or benefits that may be bestowed upon them.⁹⁹ For example, a person who drops a lighted match in the forest is considered irresponsible because she has not considered the consequences of those actions.¹⁰⁰ Third, a morally responsible person also must reflect on their freedom to act, weigh their alternatives, possess a desire to do the "right" thing, and, if called upon, be able to justify their actions.¹⁰¹ Thus, in addition to rule following, Stone creates a decision process that a responsible person would go through before acting. For a corporation, there is a counterpart to each of these processes (e.g., a corporation's information-collection system should gather the morally salient features of its environment)¹⁰² that would lead to a responsible corporation.¹⁰³

91. BOATRIGHT, *supra* note 82, at 387 (quoting a 1971 Committee for Economic Development report, COMMITTEE FOR ECONOMIC DEVELOPMENT, SOCIAL RESPONSIBILITIES OF BUSINESS CORPORATIONS 15 (1971)).

92. Epstein, *supra* note 25, at 374; CARROLL, *supra* note 27, at 32-33.

93. Epstein, *supra* note 25, at 374.

94. STONE, *supra* note 3, at 111-18; Christopher D. Stone, *Essay: Corporate Social Responsibility: What It Might Mean, If It Were Really to Matter*, 71 IOWA L. REV. 557 (1986).

95. Stone, *supra* note 94, at 559.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. STONE, *supra* note 3, at 114.

101. *Id.* at 114-15.

102. Stone demonstrates this point by describing a cartoon from *The New Yorker*:

In the cartoon, two men, apparently public officials, have led a third, a high corporate officer, to a wall of his plant which abuts and overlooks a waterway. From this prospect, the officer can look down to see three huge pipes from which his company is dumping pollutants into the water. With a look of perfectly ingenuous surprise, he remarks, "So *that's* where it goes! I'd like to thank you fellows for bringing this to my attention."

Id. at 116.

103. *Id.* at 117-18.

B. Corporate Social Responsiveness

Stone's process-oriented notion of social responsibility is related to the concept of corporate social *responsiveness*. Social responsiveness refers to the "capacity of a corporation to respond to social pressures."¹⁰⁴ To identify a socially responsive corporation, "[o]ne searches the organization for mechanisms, procedures, arrangements and behavioral patterns that, taken collectively, would mark the organization as more or less capable of responding to social pressures."¹⁰⁵ John Boatright distinguishes social responsibility from social responsiveness with an analogy: "[A] *responsible* motorist is one who stops to offer whatever aid is available to another motorist in distress; but a *responsive* motorist is one who carries a flashlight, tools, battery cables, and so on and is prepared to offer effective aid."¹⁰⁶ Thus, instead of reacting to a crisis (or fulfilling a responsibility) in a "knee-jerk" fashion, the corporation has procedures in place to anticipate crises and react in "fruitful, humane, and practical ways."¹⁰⁷ The variety of social demands that corporations must respond to include the economic, legal, ethical, and discretionary responsibilities described above.¹⁰⁸

Stakeholder theory, perhaps currently the most popular business ethics theory, also recognizes the need to be responsive to the demands of members of the public who will be affected by (i.e., have a "stake" in) the corporation's actions. The list of stakeholders typically includes such members of the public as employees, consumers, suppliers, creditors, the local community, governments, and stockholders. The basic idea of stakeholder theory is that "[s]ince corporations not only depend on but also affect the lives of numerous identifiable groups, someone in the executive suite ought to pay some attention to their rights and to the impact of corporate operations."¹⁰⁹ To effectively practice stakeholder management, a corporation must have procedures in place to identify

104. Frederick, *Maturing*, *supra* note 83, at 154; see also ROBERT ACKERMAN & RAYMOND BAUER, *CORPORATE SOCIAL RESPONSIVENESS: THE MODERN DILEMMA* [sic] 6-16 (1976).

105. Frederick, *Maturing*, *supra* note 83, at 154-55.

106. BOATRIGHT, *supra* note 82, at 390.

107. Frederick, *Maturing*, *supra* note 83, at 156.

108. In addition to the ideas of social responsibility and responsiveness discussed above, Epstein adds a third category of "Business Ethics." Epstein, *supra* note 25, at 368. These three categories are "normative analytical frameworks which assist business decisionmakers in selecting from among . . . conflicting societal values and in applying them to specific cases." *Id.* The idea of business ethics focuses primarily on "moral reflection." Edwin Epstein, *The Corporate Social Policy Process: Beyond Business Ethics, Corporate Social Responsibility, and Corporate Social Responsiveness*, 29 CAL. MGMT. REV. 99, 104 (1987) [hereinafter Epstein, *Corporate Social Policy*]. Stone's concept of social responsibility would fit under Epstein's classification of "business ethics." See Epstein, *supra* note 25, at 369 ("Ethical analysis does not operate as a rigid set of rules. It provides, rather, a process and a framework by which individuals and organizations (and even whole societies) can determine and evaluate their actions from the perspective of essential moral principles and values."). The other two classifications are consistent with what was provided here. See Epstein, *Corporate Social Policy*, *supra*, at 104-05; Epstein, *supra* note 25, at 372-77.

109. FREDERICK, *supra* note 27, at 213. Stakeholder theory is Kantian in the sense that each stakeholder group has a right to be treated as an end in itself, and not to be treated as a means to some end. WILLIAM M. EVAN, *ORGANIZATION THEORY: RESEARCH AND DESIGN* 336 & 340 (1993). For a discussion of the "stake" some of the principal stakeholder groups have in the corporation, see *id.* at 362-63.

the relevant stakeholders and respond to them appropriately.¹¹⁰ Thus, rather than responding to social issues, corporations are responding to stakeholder issues.¹¹¹

The idea that stakeholders should be considered in corporate decisions first entered the legal debate in the 1930s when A. A. Berle and Merrick Dodd argued over the question: "For whom should corporate managers be trustees?"¹¹² This debate was revived in the law during the flurry of takeovers in the 1980s. In *Unocal Corp. v. Mesa Petroleum Co.*,¹¹³ the Delaware Supreme Court stated that directors and management could consider the interests of other constituencies (i.e., stakeholders) when determining the nature of the threat posed by a takeover bid.¹¹⁴ Currently, over half the states have statutes that permit the consideration of these interests to some degree by statute.¹¹⁵ The debate over the proper interpretation of these statutes and whether they should apply to all corporate decisions is far from over, however.¹¹⁶

C. Critique of Social Responsiveness and the Idea of Social Contracts

Both the corporate social responsiveness viewpoint and stakeholder theory have been challenged by claims that they fail to provide management with any clear guidance on how to behave. The idea of corporate social responsiveness fails to provide a normative standard or a set of values for management to follow in responding to societal

110. For a strategy to effectively analyze and respond to stakeholders, see R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* 83-191 (1984). The determination of who is a stakeholder can have a narrow definition or a broad definition. The narrow definition includes stakeholder groups "who are vital to the survival and success of the corporation," while the broad definition includes "any group or individual who can affect or is affected by the corporation." EVAN, *supra* note 109, at 341. For a discussion on the wide variety of stakeholder definitions proposed, see Ronald K. Mitchell et al., *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853, 855-63 (1997). For the purpose of social reports, it is necessary for reasons of practicality to adopt a fairly narrow definition of stakeholders. The determination of stakeholder groups is discussed later in the discussion of Integrative Social Contracts Theory and the methods of social reports. See *infra* Part III.C and Part V.B 3.

111. Juha Näsi et al., *The Evolution of Corporate Social Responsiveness*, 36 BUS. & SOC'Y 296 (1997).

112. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148-49 (1932) (arguing that corporate managers should be trustees for employees, customers, and the general public, as well as the shareholders); Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) (arguing that corporate managers should only be trustees for shareholders); see also Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (starting this debate).

113. 493 A.2d 946 (Del. 1985).

114. *Id.* at 955.

115. For lists of these state statutes, see Note, *Corporate Social Responsibility Through Constituency Statutes: Legend or Lie?*, 11 HOFSTRA LAB. L.J. 461, 462 n.5 (1994); Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587, 613 n.140 & 620 n.171 (1997).

116. For a review of possible interpretations of constituency statutes, see Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 16 (1992).

pressures.¹¹⁷ Similarly, stakeholder theory has been criticized for its failure to provide guidance in how to weigh and balance the interests of the relevant stakeholders.¹¹⁸

As a possible solution to such problems, Thomas Donaldson and Thomas Dunfee have offered their revised version of social contract theory.¹¹⁹ Their version, termed Integrative Social Contracts Theory (ISCT), focuses on our "bounded moral rationality"¹²⁰ in economic ethics and the artifactual character of business.¹²¹ Due to the artifactual nature of business, we are free to shape the "rules" of the economic game.¹²² These rules are shaped by the social norms of society's various economic communities. Within these communities (that can be grouped by industry, firms, departments within a firm, geographic region, profession, and so forth¹²³), the members are free (have "moral free space") to determine their own norms for economic behavior.¹²⁴ These norms, however, must be both "authentic" and "legitimate."¹²⁵ A norm is authentic if the members of the community have informed consent regarding a norm, and have the right to exit the community if they disagree with a norm.¹²⁶ A norm is legitimate if it is not inconsistent with a "hypernorm."¹²⁷ Hypernorms are those norms that are fundamental to human existence, such as basic human rights.¹²⁸ These are higher-order norms that place

117. BOATRIGHT, *supra* note 82, at 390; R. EDWARD FREEMAN & DANIEL R. GILBERT, JR., CORPORATE STRATEGY AND THE SEARCH FOR ETHICS 104-05 (1988); Frederick, *Maturing*, *supra* note 83; Barry M. Mitnick, *Systematics and CSR: The Theory and Processes of Normative Referencing*, 34 BUS. & SOC'Y 5 (1995).

118. THOMAS DONALDSON, THE ETHICS OF INTERNATIONAL BUSINESS 45-46 (1989); Thomas W. Dunfee & Thomas Donaldson, *Contractarian Business Ethics: Current Status and Next Steps*, 5 BUS. ETHICS Q. 173, 175 (1995).

119. See DONALDSON & DUNFEE, *supra* note 30, at 235-62 (showing the advantages of viewing stakeholder theory from a social contracts perspective). For a discussion on Integrative Social Contracts Theory, see Thomas Donaldson & Thomas W. Dunfee, *Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 ACAD. MGMT. REV. 252 (1994) [hereinafter Donaldson & Dunfee, *ISCT*]; Thomas Donaldson & Thomas W. Dunfee, *Integrative Social Contracts Theory: A Communitarian Conception of Economic Ethics*, 11 ECON. & PHIL. 85 (1995) [hereinafter Donaldson & Dunfee, *Communitarian Conception*].

120. Bounded moral rationality refers to the cognitive inability of moral agents to comprehend all the details relevant to an ethical decision and potential clashes between what moral theory would dictate and what one's own common sense moral conviction would. Donaldson & Dunfee, *ISCT*, *supra* note 119, at 255-58. The artifactual nature of business is a third way in which rationality in economic ethics is bounded. *Id.* at 257-58.

121. The artifactual character of business refers to the fact that economic systems are not the product of nature but are created entirely by people. *Id.* at 257.

122. *Id.*

123. Donaldson and Dunfee define a community as "a self-defined, self-circumscribed group of people who interact in the context of shared tasks, values or goals and who are capable of establishing norms of ethical behavior for themselves." *Id.* at 262.

124. Donaldson & Dunfee, *ISCT*, *supra* note 119, at 260.

125. *Id.* at 263.

126. *Id.* at 262-63. One may empirically determine the existence of an authentic norm by such methods as seeing if the deviance from a certain norm in a certain situation is disapproved of by most members of the community, or if a substantial majority of the community members act in accordance with a certain norm when facing the particular situation of interest. *Id.* at 263-64.

127. *Id.* at 265.

128. Donaldson & Dunfee, *ISCT*, *supra* note 119, at 265. Such norms are expected "to be reflected in a convergence of religious, philosophical, and cultural beliefs." *Id.* As norms between communities may come into conflict (*i.e.*, a certain practice may affect multiple communities), there are priority rules to determine which norm should be followed. *Id.* at 268-70.

only the minimal, necessary restrictions upon the ability of communities to develop their own norms.

Donaldson and Dunfee argue that ISCT may serve as a normative foundation for stakeholder theory.¹²⁹ In this context, applying stakeholder theory requires looking to the relevant community norms to determine who is a stakeholder and what obligations the corporation owes the stakeholders.¹³⁰ When there are conflicting norms, the authors suggest that the situation becomes almost an empirical question of identifying the dominant legitimate norms.¹³¹ In a situation in which there are neither dominant norms nor well-defined norms, corporations are in the realm of "moral free space," which is similar to Carroll's discretionary responsibilities discussed above.¹³² Although corporations have discretion in making decisions in such a situation, their recognition of the non-existence of a norm may lead to a fruitful discussion within the relevant community and a resolution on what should be the proper norm. Importantly, it should not be forgotten that any action contemplated by a corporation must be in compliance with the relevant hypernorms.

The foregoing discussion demonstrates the necessity for corporations to conform to the norms and expectations of society. Corporate social responsiveness and stakeholder theory advance the idea that corporations be responsive to the demands of those with a stake in the company. Social contracts theory gives substantive meaning to these ideas by grounding such responsibilities in community norms of proper behavior.¹³³ The

129. DONALDSON & DUNFEE, *supra* note 30, at 235; see also Dunfee & Donaldson, *supra* note 118, at 181.

130. DONALDSON & DUNFEE, *supra* note 30, at 250-62.

131. Sometimes, the dominant community may not be the local community, but the national community. For example, in a plant relocation decision, the local community may not want the plant to move because they desire to protect local jobs. The national community, however, may favor a relocation that would produce the greatest societal wealth. This national community would encompass the local community, as well as the other potentially affected communities, and its norms would determine whose interests should be given the most weight. See DONALDSON & DUNFEE, *supra* note 30, at 186-87 (discussing the priority given to higher-level communities when norms conflict).

132. See *supra* note 90 and accompanying text.

133. The idea of social norms is clearly not new to the field of law. Law and Society scholars have long recognized the importance of social norms as informal controls on behavior. See, e.g., Robert C. Ellickson, *Law and Economics Discovers Social Norms*, 27 J. LEGAL STUD. 537, 546 (1998) (citing the works of Stewart MacAulay, *Non-Contractual Relations in Business*, 28 AM. SOC. REV. 55 (1963), and H. LAURENCE ROSS, *SETTLED OUT OF COURT* (rev. ed. 1980)) [hereinafter Ellickson, *Social Norms*]. Recently, Law and Economics scholars have also begun studying the importance of social norms in a wide variety of areas. See generally Richard McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338 (1997); Symposium, *Law, Economics, and Norms*, 144 U. PA. L. REV. 1697 (1996); Symposium, *Social Norms, Social Meaning, and the Economic Analysis of Law*, 27 J. LEGAL STUD. 537 (1998). Robert Ellickson's empirical work on ranchers in Shasta County, California, is especially relevant here. Ellickson shows that in many situations social norms regulate behavior more effectively than legal entitlements or legal restrictions. ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 4 (1991) [hereinafter ELICKSON, *ORDER WITHOUT LAW*]. Ellickson argues that "[t]he Shasta County findings add to a growing library of evidence that large segments of social life are located and shaped beyond the reach of the law. Despite this mounting evidence, the limits of law remain too little appreciated." *Id.* The concern here, in part, is not with the relative importance of informal and formal social controls, or how the law can manipulate norms to achieve desired outcomes, see Ellickson, *Social Norms*, *supra*, at 548 (describing scholars in the area Lawrence Lessig, a professor at Harvard Law School, termed the "New Chicago School" as tending to "favor governmental activism in the molding of norms"), but with how the law can guide corporations to understand and follow societal norms.

discussion now turns to how social reports, as a reflexive law approach, can achieve the desired goal of corporate social responsiveness and guide corporations in being responsive to those community norms, whereas substantive law cannot.

IV. SOCIAL RESPONSIVENESS: THE NEED FOR A REFLEXIVE LAW APPROACH

Our goal is to create a regulatory system that encourages corporations to be socially responsive. To do this, corporations must have an understanding of what society expects of them and be stimulated to behave in a way that is responsive to those demands. Due to value pluralism in society and the continual evolution of societal values, substantive law is incapable of creating such a regulatory system.

There are several reasons why substantive law is incapable of producing socially responsible behavior from corporations.¹³⁴ First, the juridification problem discussed above¹³⁵ is particularly relevant in the area of social responsibility. Any attempt to regulate all important aspects of corporate behavior that have an impact on society, and to make the regulatory system sufficiently representative of social reality to apply to the variety of corporate situations, would create a sea of law too complex for an organization to effectively comply with. Furthermore, the potential for legislatures or regulatory agencies to pass contradictory legislation and rules is great, as it would be extremely difficult to harmonize the vast body of laws that would influence corporate behavior.

Second, substantive law is primarily reactive.¹³⁶ There is inevitably a time-lag between determining what is responsible behavior and then implementing regulation to that effect. Thus, the law can permit irresponsible behavior until an appropriate regulation is implemented. In addition, the time-lag problem is continually recurring as society's values are constantly evolving.

Third, there are problems with implementing the law. Normative legitimacy¹³⁷ problems arise when the regulatory system becomes so complex that the legislature must delegate a vast amount of discretion to the regulatory agencies in enforcing and giving shape to the laws. In addition, the costs of enforcing laws in the area of social

134. Teubner's arguments on the failure of substantive regulation focus on his discussion of systems theory and the self-reproducing nature of subsystems (autopoiesis). Gunther Teubner, *After Legal Instrumentalism? Strategic Models of Post-Regulatory Law*, in *DILEMMAS OF LAW IN THE WELFARE STATE* 299, 310-12 (Gunther Teubner ed., 1986). Teubner formulates a "regulatory trilemma" that considers the inability of the legal subsystem using substantive law to produce meaningful behavioral changes in the other subsystems without the risk of destroying the regulated subsystems' traditional patterns of social life. *Id.* The trilemma first consists of the incongruence of law, politics, and society. *Id.* at 311. Thus, any regulation may not be able to produce the desired changes in behavior and will be only of symbolic use. *Id.* Second, the "over-legalization" of society causes significant changes to the internal interactions of the subsystem's elements and destroys the "reproduction of traditional patterns of social life." *Id.* Third, the "over-socialization" of law results from the law being "captured" by the regulated subsystem or politics. Teubner, *supra*, at 311.

It is not necessary to get into the details of systems theory (or even to fully accept the theory) to see the benefits of reflexive law over substantive law. For a critique of the autopoietic law paradigm, see Arthur J. Jacobson, *Autopoietic Law: The New Science of Niklas Luhmann*, 87 MICH. L. REV. 1647 (1989).

135. See *supra* text accompanying notes 65-69.

136. STONE, *supra* note 3, at 94. Stone does not use the distinction between the "types" of law used in this article, that is, formal, substantive, and reflexive law.

137. See *supra* text accompanying notes 70-71.

responsibility may outweigh the benefits.¹³⁸ Systematically policing and enforcing all the substantive laws necessary to create socially responsible corporations would create great needs for increasing administrative agencies and would create further burdens on our court system.

Finally, there is a problem of framing society's values in regulatory language.¹³⁹ In our value-pluralistic society,¹⁴⁰ there is a lack of consensus on what values we want the law to advance. For example, in the area of environmental law, society may agree that excessive air pollution should be banned, but what "excessive" means can vary greatly between persons.¹⁴¹ Any agreement will be very general and can result in statutes that are written in vague language, which will inevitably lead to disputes on what the parties' rights are under that statute. Trying to give more substance to these vague laws then leads to the juridification and normative legitimacy problems discussed above.¹⁴² Furthermore, the structure of substantive law is typically along the lines of duties ("thou shalt not discriminate on the basis of sex") and not aspirations ("thou shalt do justice").¹⁴³ Thus, corporations are not being encouraged to develop new solutions to existing (or potential) problems, but only to meet a certain minimum level of behavior.

The failure of substantive law in the area of corporate social responsibility opens the door for reflexive law.¹⁴⁴ The move to reflexive law in this area can be seen in current proposals for legislation that focus on the decision process rather than substantive outcomes.¹⁴⁵ These proposals have been along the lines of creating fiduciary duties to

138. STONE, *supra* note 3, at 104.

139. *Id.* at 97-103.

140. See text accompanying *supra* note 29 (defining value pluralism in American society).

141. See *id.* at 97.

142. See *supra* text accompanying notes 65-71, 135, 137-138.

143. *Id.* at 101.

144. The mechanisms for guiding corporate social responsibility are often seen as a choice between "law" and "morality." See Teubner, *supra* note 76, at 158. Law refers to "external legal control," or most closely to what this article refers to as substantive law. *Id.* Morality refers to the "internal moral controls" of management's actions. *Id.* The problems of relying on "law" for corporate social responsibility were discussed earlier as the problems of substantive law. See *supra* Part IV. The problems of relying on morality are summed up by Teubner as "[t]he impotence of morality as a control mechanism in the face of imperatives of economic rationality. . . ." Teubner, *supra* note 76, at 158. The goal of reflexive law, then, is to "utilize the law to compel firms to behave 'morally,' i.e. to take account of the social consequences of their actions." *Id.* at 159.

145. In the area of corporate social responsibility, the law has generally followed the evolution from formal law to substantive law, and, as this article argues, is now needed to move to reflexive law. For a general history of corporate social responsibility law, see STAFF REPORT, *supra* note 28, at 236-50.

The issues of corporate social responsibility first came up in the law in the general context of corporate philanthropy, and the law followed a very formal approach. Mark Sharfman, *Changing Institutional Roles: The Evolution of Corporate Philanthropy, 1883-1953*, 33 BUS. & SOC'Y 236 (1994); Note, *supra* note 115. For a discussion of corporate philanthropy and the evolution of its acceptance under the law, see generally Edward S. Adams & Karl D. Knutsen, *A Charitable Corporate Giving Justification for the Socially Responsible Investment of Pension Funds: A Populist Argument for the Public Use of Private Wealth*, 80 IOWA L. REV. 211 (1995). The traditional rule at the common law was that corporations could not give to charity because they were required to maximize their profits by undertaking only those activities listed in their charter. As early as 1896, however, in *Steinway v. Steinway & Sons*, 40 N.Y.S. 718, 720-21 (N.Y. Sup. Ct. 1896), the courts approved corporate philanthropic expenditures, but only if those expenditures had some reasonable relation to promoting the shareholder's ends. This is one of the earliest applications of the "direct corporate benefit doctrine." Adams & Knutsen, *supra*, at 233.

stakeholders (or, at a minimum, permitting the consideration of these interests in corporate decisions via "other-constituency" statutes) or permitting stakeholder representation in the corporate decision process. The debate over these proposals is beyond the scope of this Article, but the piece will note the major problems with these proposals. First, "other constituency" statutes can actually promote unaccountability by allowing management to hide behind the statutes;¹⁴⁶ by making management accountable to everyone, they may become accountable to no one. Second, the idea of constituency directors has been attacked on the grounds of impracticality.¹⁴⁷

Instead, what is needed is legislation that will not just apply to the boardroom, but will come closer to effectively impacting the way a corporation's day-to-day decisions are made.¹⁴⁸ The law must require corporations "to internalize outside conflicts in the

In applying this doctrine, however, the courts would not simply defer to management's judgement on what actions were in furtherance of the corporation's legitimate ends, as shown in the well-known case of *Dodge v. Ford Motor Co.*, 170 N.W. 459 (Mich. 1919), where the Court found that Henry Ford's plan to reduce the price of the company's cars (which Ford thought would be in the best interest of the community) was not in the best interests of the shareholders. *Id.* at 507. Shortly after *Dodge*, state legislatures began to adopt legislation explicitly permitting corporate charitable donations. By 1960, 46 states and territories had adopted legislation approving corporate charitable giving. Sharfman, *supra*, at 255. (Today, every state has such legislation. For a listing of the statutes, see Adams & Knutsen, *supra*, at 232 n.115.) The law recognized that corporations may engage in the socially responsible activity of charitable giving (of a limited amount), but this has generally been supported on the basic proposition that it is good for business, and therefore the shareholders, to do so. Thus, corporations were allowed to benefit non-shareholder interests, but only if the formal law rule that such action benefits shareholders was met.

A move to substantive law in the area of corporate social responsibility began in the 1930s, but seemed to increase dramatically in the 1960s and 1970s. See STAFF REPORT, *supra* note 28, at 244-45 (summarizing the legislation discussed next). This time period brought direct legislation of pollution and hazardous waste control (*i.e.*, the Federal Water Pollution Control Act, the Clean Air Act Amendments of 1977, the Noise Control Act of 1977, the Resource Conservation and Recovery Act, the Toxic Substances Control Act, and the Federal Insecticide, Fungicide, and Rodenticide Act), the workplace (*i.e.*, the Occupational Safety and Health Act of 1970, and the Equal Employment Opportunity Act of 1972), and consumers (*i.e.*, the Consumer Product Safety Act, the Federal Hazardous Substances Act, the Poison Prevention Packaging Act of 1970, and the Delany Food Additives Act). Thus, the government, through legislation, directly interfered in the market to limit the choices of business and to attempt to obtain the outcomes it desired. The problems of this reliance on substantive law create the need for the move to reflexive law.

146. Rima Fawal Hartman, *Situation-Specific Fiduciary Duties for Corporate Directors: Enforceable Obligations of Toothless Deals?*, 50 WASH. & LEE L. REV. 1761, 1763, 1786-87 (1993); Note, *supra* note 115, at 483; cf. David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in PROGRESSIVE CORPORATE LAW 1, 14-15 (Lawrence E. Mitchell ed., 1995); Eric Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 16, 123-28, 134 (1992).

147. Irving Shapiro has pejoratively labeled such statutes "Noah's Ark proposals" and argues that the board cannot look out for the interests of the whole organization if each director is by definition to look out for the interests of their group. Irving Shapiro, *Power and Accountability: The Changing Role of the Corporate Board of Directors*, in ETHICAL ISSUES IN BUSINESS: A PHILOSOPHICAL APPROACH 437, 437-47 (Thomas Donaldson & Patricia Werhane eds., 3d ed. 1988). For further criticism of such proposals, see David Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1 (1979). In addition, there seems to be little support for such proposals among managers, directors, and shareholders. See ABASS ALKHAFI, A STAKEHOLDER APPROACH TO CORPORATE GOVERNANCE: MANAGING IN A DYNAMIC ENVIRONMENT 115 (1989) (presenting the results of a survey finding that all levels of management disagreed with the idea that stakeholders should be represented on the board of directors). Trying to force such proposals on these parties will likely face strong resistance.

148. Although social reports will impact the daily operations of the corporation, they will also provide the board of directors with information on the corporation that it may not otherwise have. Some corporations have

decision structure itself in order to take into account the non-economic interests of workers, consumers, and the general public."¹⁴⁹ However, the law must also recognize that different corporations are in different situations—due to variations in size, industry, geographic location, or any other number of factors¹⁵⁰—and they need the freedom to be able to respond to their unique situations in the best manner possible. As ISCT argues, what is needed is an agreement between the corporation and its stakeholders as to what responsible behavior is, and then compliance with that agreement.¹⁵¹

This is not to say that the law must act to equalize the power relationship between the corporation and its stakeholders. In the area of social responsibility, "responsiveness to human needs is what is required and not neutralization of power."¹⁵² The idea is not to focus on creating a "power-equilibrium," but to focus on growth and a "mutual power increase" where the corporation and its stakeholders can more effectively communicate and influence each other.¹⁵³ Adopting a reflexive law approach also does not mean abandoning all substantive law. What it does mean, however, is that society "has to give up concepts of comprehensive social planning since they are utopian and unrealistic."¹⁵⁴

created public policy committees on their board of directors to alleviate the problem that social issues are rarely presented to the board. STAFF REPORT, *supra* note 28, at 315-18.

149. Teubner, *supra* note 76, at 165.

150. Comparing for-profit corporations with non-profit organizations, municipalities, and other corporations, Edwin Epstein states:

Although all of these entities are engaged in the production of and distribution of socially useful goods and services, each performs a very different social task, has different constituencies, affects widely divergent sectors of the public, has different human and capital resources, and poses substantially different issues of corporate power and accountability.

Edwin Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, 30 HASTINGS L.J. 1287, 1289 (1979).

151. See *supra* notes 119-132 and accompanying text (discussing ISCT and its implications for stakeholder theory).

152. Teubner, *supra* note 134, at 318.

153. See *id.*

154. *Id.* at 320. Moreover:

Many corporate social problems do not feasibly lend themselves to the traditional legal treatments even to start with. In those cases, what seems needed as a 'remedy' is some institutional analogue to the role that responsibility plays in the human being, guiding action toward certain values where the ordinary legislative prohibitions are unavailable or, on balance, unwise.

STONE, *supra* note 3, at 120.

Related to this discussion is what Lon Fuller has termed the Morality of Aspiration ("the fullest realization of human powers") and the Morality of Duty (the basic rules for an ordered society). LON FULLER, *THE MORALITY OF LAW* 5 (1969); see also *supra* text accompanying notes 139-143 (discussing the problems of framing society's values in regulatory language). Fuller discusses a "moral scale" that starts with the basic demands of social living and extends to "the highest reaches of human aspiration." FULLER, *supra*, at 9-10. Somewhere along this scale society places a "pointer" that determines where duty ends and aspiration begins.

Those whom we regard as being unpleasantly—or at least, inconveniently—moralistic are forever trying to inch the pointer upward so as to expand the area of duty. Instead of inviting us to join them in realizing a pattern of life they consider worthy of human nature, they try to bludgeon us into a belief we are duty bound to embrace this pattern.

Id. at 10. Likewise, over-reliance on substantive law in the area of social responsibility continues to raise the "pointer" higher and higher and limits the alternatives available to business to respond to society's expectations.

Instead of relying solely on substantive law, reflexive law promotes reliance on process. Relevant to this discussion is Edwin Epstein's view of corporate social responsibility as a process. Epstein describes the "corporate social policy process" as "a system of decision-making whereby corporate managers try to anticipate and consider the total consequences of business policies and operations before they act."¹⁵⁵ This must involve the careful consideration of the well-being and interests of the stakeholders to the firm and relevant community norms.

To achieve the goal of social responsiveness, this Article argues for a reflexive law approach of mandatory social reporting. Since the time the concept of social responsiveness was developed, proponents of this view have promoted the use of social reports, in some form, as an essential tool for achieving responsiveness.¹⁵⁶ How these social reports were to be used, however, could vary dramatically between commentators. For example, some proposed that social reports should only be used internally for a company's review of its practices,¹⁵⁷ while others wanted full disclosure to the public.¹⁵⁸

For the form of social reports advocated here, it is important to remember that they are being used as a reflexive law regulatory approach. It is also important to remember that the regulatory goal of corporate social responsiveness is grounded in social contract theory. The social norms of the corporation's relevant communities will guide the corporation in determining the shape and substance of the duties owed to its stakeholders. The social report will aid the company in recognizing the relevant (and evolving) norms, and will allow the community members (stakeholders) to determine if the corporation is abiding by those norms. Although it did not explicitly mention social contract theory, the Sbn Bank of Denmark, one of the pioneers in the revival of social reports, took a similar view. In the bank's first social report, the authors stated:

Ideally, a decision is ethical if the parties influenced by it agree. Therefore, ethics deals with values which are strong enough to be shared and with conflict resolution via attunement of these values. The Ethical Accounting statement is based on the values that are shared by the company and its stakeholders. . . .

155. Epstein, *supra* note 150, at 1303. Fully stated, the "corporate social policy process" advocated by Epstein is:

Institutionalization within the corporation of processes facilitating value-based individual and organizational reflection and choice regarding the moral significance of personal and corporate action. Individual and collective examination of the likely overall consequences of such actions, thereby enabling the firm's leaders both individually and collectively within the organizational setting to anticipate, respond to and manage dynamically evolving claims and expectations of internal and external stakeholders concerning the products (specific issues or problem-related consequences) or organizational policies and behavior.

Epstein, *Corporate Social Policy*, *supra* note 108, at 107.

156. See ACKERMAN & BAUER, *supra* note 104; see also sources cited *infra* note 162.

157. See Raymond A. Bauer & Dan H. Fenn, *What Is a Corporate Social Audit?*, HARV. BUS. REV. Jan.-Feb. 1973, at 43, 43-44 (1973).

158. See Simon Zadek et al., *How to Do It*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 35, 43-44; see also NEIL W. CHAMBERLAIN, *SOCIAL STRATEGY AND CORPORATE STRUCTURE* 75 (1982) (stating that, "[b]asically there are two camps—those who believe that the corporate social audit is a management tool, for internal use, and those who believe it is, in addition, a system of disclosure that a company owes to the public").

The Ethical Accounting Statement measures the degree to which the company lives up to these shared values.¹⁵⁹

Social report legislation may be termed a "reflexive law" because the law will not command any particular outcome, but will guide corporations in thinking "critically, creatively, and continually"¹⁶⁰ about how they are performing socially and how they can improve. To ensure meaningful social responsiveness, it is important that social reports be publicly disclosed, developed through the participation of stakeholders, and capture the corporation's progress toward certain goals over time. Such a process will allow for continually evolving societal norms to influence and guide corporate behavior. Furthermore, this process will create a regulatory system that provides necessary freedom for business decisions and is responsive to each corporation's individual situation. Importantly, however, social report legislation would not supplant substantive law, but would compliment it by taking over where substantive law ends in the area of corporate social responsibility.

These issues are all discussed more fully below,¹⁶¹ but it can be noted here that social reports will achieve corporate social responsiveness by promoting: (1) improved and informed corporate decisions with full understanding of the implications of any action; (2) accountability to the public through disclosure; (3) an understanding of community and stakeholder expectations of business and of the evolution of those expectations; and (4) a measurement of progress towards meeting those expectations. Overall, such a system will allow corporations to pursue their profit objective, but in a manner that is responsive to the expectations of society.

V. SOCIAL REPORTING

Social reports gained a significant amount of attention in the 1970s,¹⁶² but this movement dwindled in the 1980s.¹⁶³ In the 1990s, the social report has regained strength, in large part due to the attention given environmental audits.¹⁶⁴ Throughout the history of

159. Peter Pruzan, *The Ethical Dimensions of Banking: Sbn Bank, Denmark*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 63, 67.

160. Orts, *supra* note 9, at 780.

161. See Part V.B (naming the necessary requirements of social reporting to achieve reflexive law goals).

162. See, e.g., CLARK C. ABT, *THE SOCIAL AUDIT FOR MANAGEMENT* (1977); RAYMOND BAUER & DAN H. FENN, JR., *THE CORPORATE SOCIAL AUDIT* (1972); DAVID BLAKE ET AL., *SOCIAL AUDITING* (1976); RALPH ESTES, *CORPORATE SOCIAL ACCOUNTING* (1976).

163. Zadek et al. argue that:

The 1980s in some ways did not provide a conducive environment for the development of social auditing. It was a period when business was arguably given more of a 'green light' to set its own terms for engagement with society than at any other time in this century, certainly in the industrial world.

Zadek et al., *supra* note 13, at 18.

164. For a listing of European institutions established to study social and environmental audits, see *supra* note 37. In the U.S., the most visible work on social auditing is being done by the Council on Economic Priorities in New York, which has published popular books giving their external social evaluation of many U.S. corporations. See LYDENBERG ET AL., *supra* note 15; COUNCIL ON ECONOMIC PRIORITIES, *supra* note 16. The social reports that The Body Shop and Ben & Jerry's have conducted have also created publicity for social reports. See *infra* Part VI.

social reporting, the terminology and approaches used have varied widely. These variations include "social auditing and reporting," "ethical accounting," and "social evaluation,"¹⁶⁵ and can range from audits that attempt to place a financial cost on every action with a social impact,¹⁶⁶ to those with a simple focus on whether or not the corporation is performing some approved conduct.¹⁶⁷ For ease of use, this Article adopts the term "social report" to include social accounting (the actual measurement and recording of information), social auditing ("the effort to evaluate companies' social performance against selected standards and/or expectations"), and social reporting (the disclosure of the collected information to the public).¹⁶⁸

Peter Pruzan of the Copenhagen Business School provides a useful description of a social report¹⁶⁹ that lays out its basic features:

[A social report] provides measures of how well an organization lives up to the shared values [created jointly with its stakeholders] to which it has committed itself. It contributes to a dialogue process where values become integrated into the organization. It provides an extensive picture of the organization's relationships with its stakeholders, and thus of its chances for long-term development and survival. But it encompasses more than just a snapshot at a particular time; its design, development and interpretation contribute to an ongoing dialogue culture where values become vital for the organization's self-reference.¹⁷⁰

Appropriate legislation should require corporations to follow a social reporting procedure that meets this definition. A discussion of the details of conducting a social report is beyond the scope of this Article, however. Instead, this Article presents only the basic elements of a social report that are necessary to achieve the regulatory objective of social responsiveness discussed above. In Part VI, this Article will provide current examples of two companies' social reports to demonstrate how these objectives are met in practice.

A. Implementing Social Reporting Legislation

The goal of reflexive regulation is not to cause corporations to engage in "defensive compliance,"¹⁷¹ but to encourage proactive, socially responsive management. However,

165. Zadek et al., *supra* note 158, at 41 (providing a typology of social reports).

166. See BLAKE ET AL., *supra* note 162, at 2-5.

167. Zadek et al., *supra* note 158, at 38 (noting that such reports were done mostly by external parties). Bauer and Fenn identify four types of social reports. BAUER & FENN, *supra* note 162, at 16-17. First, a report can show that the company is not doing any social harm, such as the company is not currently under indictment by any government agency. *Id.* at 16. Second, a social report may simply show the "subjective impressions of knowledgeable and concerned people who have collected some data and talked with many observers." *Id.* Third, the report could thoroughly review a corporation's action in specific areas, such as air or water pollution. *Id.* at 17. Fourth, a report may attempt to "develop quantitative measures of social responsibility." *Id.*

168. Meinolf Dierkes, *Corporate Social Reporting and Auditing: Theory and Practice*, in CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 354, 355-56 n.1 (Klaus J. Hopt & Gunther Teubner eds., 1985). The terms "audit" and "report" may be used somewhat interchangeably in this article.

169. Pruzan uses the term "ethical accounting statement." Pruzan, *supra* note 159, at 68.

170. *Id.*

171. Orts, *supra* note 8, at 1287 (arguing that current environmental regulations may only "encourage defensive compliance").

because the accounting community is still in the relatively early stages of developing the necessary standards of social accounting, auditing, and reporting, social report legislation should not be mandated immediately but instead be implemented in stages.¹⁷² Mandating social reporting before the process is more fully understood through experience may result in companies focusing on the form of the report over the substance. The first stage would involve non-mandatory legislation that would encourage companies to experiment with social reporting and work with accounting institutions to gain the practical experience necessary to develop the needed standards. The development of a compliance label to be issued to corporations that produce social reports meeting certain minimum requirements would be a useful incentive.¹⁷³ Corporations would be allowed to place this label on their products or use it in their promotional literature. Such a label would not indicate that a corporation is a government-approved socially responsible corporation, but only that the corporation has complied with the government-approved standards for social reporting.¹⁷⁴ With such incentives,¹⁷⁵ more corporations would be expected to engage in social reporting over time, and the quality of the reports should improve in the same manner that the quality of environmental audits have improved over the last several years.¹⁷⁶ The development of these standards should not be the sole responsibility of accounting institutions, but be developed jointly with all stakeholder interest groups. Once these groups have established sufficient standards, the process of implementing mandatory legislation could begin.¹⁷⁷

172. See Simon Zadek et al., *Accountable Futures*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 50, 53-54 (discussing a spectrum of standards, from industry leadership in benchmarking to mandatory legislation).

173. See Orts, *supra* note 8, at 1324-27, for a discussion of potential incentives to encourage corporations to undertake environmental auditing, including evidentiary privilege for the underlying information gathered in the production of an environmental report and an environmental labeling program.

174. In this sense, this proposal is different from proposals such as the Council of Economic Priorities' Social Accountability 8000. See COUNCIL ON ECONOMIC PRIORITIES ACCREDITATION AGENCY, SOCIAL ACCOUNTABILITY 8000 (1997) (on file with author); DR. ANDREAS STURM ET AL., SA 8000: CORPORATE SOCIAL ACCOUNTABILITY MANAGEMENT, (1999) available at <<http://www.ellipson.com/sa8000>> (1999). The primary goal of SA 8000 is to assure any interested parties, such as customers or corporate buyers, that any products sold by a SA 8000-certified company were produced in a manner that conforms to the practices and principles stated in SA 8000. *Id.* SA 8000 delineates requirements on matters such as child labor, health and safety, working hours, and compensation, among others. *Id.* To be certified, an independent, outside auditor must verify that the company has complied with these requirements. *Id.* In addition, companies are required to monitor their suppliers' commitments to the SA 8000 principles. *Id.* For example, Toys-R-Us is expected to ask its 5000 suppliers to get their plants certified. *SA8000: Proposed Global Standard for Ethical Sourcing*, 26 INT'L J. RETAIL & DISTRIBUTION MGMT. 182, 183 (1998).

175. Incentives to participate could also come from other corporations, such as banks, as a condition of extending loans, or from buyers placing pressure on their suppliers. See Orts, *supra* note 8, at 1294.

176. For recent information on advances in environmental accounting and auditing, see Environmental Protection Agency's Environmental Accounting Project (visited Sept. 9, 1999) <<http://www.epa.gov/opptintr/acctg/>>. For a listing of major corporations conducting environmental audits and the location of their environmental reports online, see *Welcome to GEMI Online: Website for the Global Environment Management Initiative* (visited Sept. 9, 1999) <<http://www.gemi.org>>; *CERES: Coalition for Environmentally Responsible Economics* (visited Sept. 9, 1999) <<http://www.ceres.org>>.

177. The potential problems with the legislative process that may prevent the adoption of the "ideal" standards is beyond the scope of this article. For some of the potential problems, see Zadek et al., *supra* note 172, at 54-55 (arguing that corporate interests opposed to social reporting legislation may lobby to create "watered-down" standards).

When developing an actual social reporting procedure from these requirements, it is important that regulators allow flexibility for the specific nature of a corporation's business. For example, it is expected that a financial services firm's social report will look different in many respects from a manufacturing company's social report. Thus, while federal legislation should establish general requirements for social reports, a panel of experts from each industry should then modify these requirements by regulation to meet the specific needs of their industry.¹⁷⁸ A key issue will be finding the necessary balance between universal requirements and industry-specific requirements. In establishing these standards, regulators should remember that social report legislation and regulations only establish that certain procedures be done appropriately, rather than mandating a particular outcome.

B. Social Reporting Requirements

The following is an initial approximation of what social reporting legislation should require. These requirements are necessary to further the goals of a reflexive law approach and avoid the pitfalls of a strictly substantive law approach. First, these requirements encourage companies to systematically engage in self-reflective behavior about how their actions impact the rest of society. Second, these requirements provide information to the public to allow the market to reward or punish a company based on that company's social performance. In addition, through the social report procedure, the company obtains information on the current market expectations of responsible behavior.¹⁷⁹

1. Mandatory

After the experimental stage discussed above, the social report must be mandatory for all corporations of a specified size. Because both private and public corporations, as well as partnerships and limited liability companies, can have a significant impact on stakeholders, it is necessary to include all of them in the social reporting requirement. The costs of creating a social report, however, may be too great for smaller firms. Therefore, limits must be placed on the size of firms required to create social reports. Section 12(g) of the Securities Exchange Act of 1934 requires any corporation¹⁸⁰ with 500 or more shareholders and more than \$5 million in assets to register with the Securities Exchange Commission and meet its disclosure requirements.¹⁸¹ Social reporting legislation could use a similar size requirement. When determining the exact cut-off point, legislators need to consider the cost burdens on smaller companies, but they also need to consider the impact those companies have on society.

178. See Orts, *supra* note 8, at 1321. The interests of all relevant stakeholder groups must be meaningfully introduced into this process, and all precautions against "regulatory capture" must be taken.

179. The following discussion relies heavily on Zadek, Pruzan, and Evans' eight principles for judging the quality of a social report. Those eight principles are: inclusivity; comparability; completeness; evolution; management policies and systems; disclosure; external verification; and continuous improvement. Zadek et al., *supra* note 158, at 41-44.

180. That is, any corporation not already subjected to the registration requirements due to being listed on a national securities exchange.

181. 15 U.S.C.A. § 78l (West 1998), modified by 17 C.F.R. § 240.12g-1 (1997).

A social report should be an annual requirement for all firms meeting the above size requirements. As opposed to a voluntary report, where firms can choose to file a report only when they are proud of their conduct, an annual report forces a firm to present a complete picture of its behavior. A social report is not intended to be a one-time, "snapshot" of a firm, but to provide a means for the company and the public to measure the company's progress over time towards meeting the demands society places on it.¹⁸² The mandatory requirement also allows corporations and the public to compare the social performance of all corporations, and to make that comparison on the basis of industry, geographic region, or any other desired categorization. In addition to providing information on any specific company's social performance, the regular publication of the reports facilitates the transfer of information between firms, and to the public generally, regarding solutions to various social problems.¹⁸³ Information on the process of conducting a social report can also be transferred through the reports themselves, and thereby improve the quality of the reports.¹⁸⁴

2. Social Reporting Procedures and Policies¹⁸⁵

The corporation must implement procedures and policies that ensure each requirement of the report is meaningfully fulfilled and that the organization is committed to the report process.¹⁸⁶ First, each corporation should create, and continually update (with the cooperation of its stakeholders), a statement of the corporation's values.¹⁸⁷ This credo or mission statement should state the expectations and goals the corporation plans to abide by. Creating a mission statement does not necessarily mean that the company will make a commitment to socially responsible activities, but should state the company's policies on issues such as treatment of employees and customers, profitability, and products or services.¹⁸⁸

182. See Zadek et al., *supra* note 158, at 44 (stating that the aim of a social auditing system "must be to assess progress rather than merely retrospective performance"). The goal of an annual requirement meets Zadek, Pruzan, and Evans' requirements of evolution (show learning over time, both of the evolving nature of stakeholder's expectations and of the firm's ability to conduct a social report) and continuous improvement (show the firm's progress over time). *Id.* at 43-44.

183. See Orts, *supra* note 8, at 1323 (noting that the regular publication of environmental audits would allow "new ideas and approaches to environmental problems [to] circulate more easily in an established system of communication").

184. See *id.*

185. See Zadek et al., *supra* note 158, at 43 (discussing management policies and systems).

186. See *Social and Ethical Accounting, Auditing and Reporting: Principles and Key Elements*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 229, 229-30 (listing some of the essential elements of an appropriate management system); Orts, *supra* note 8, at 1300 (discussing the EMAS regulation's requirements for an environmental management system).

187. For a list of values statements, see generally PATRICK E. MURPHY, EIGHTY EXEMPLARY ETHICS STATEMENTS (1998).

188. See FRED R. DAVID, STRATEGIC MANAGEMENT: CONCEPTS AND CASES 89-90 (1998) (listing a variety of components that a mission statement should include, such as customers, products or services, markets, technology, concern for survival, growth and profitability, philosophy, self-concept, concern for public image, and concern for employees). David states that a corporation's "social policy should be integrated into all strategic-management activities, including the development of a mission statement. Corporate social policy should be designed and articulated during strategy formulation, set and administered during strategy implementation, and reaffirmed or changed during strategy evaluation." *Id.* at 89. This is in line with the

Second, procedures must be established for the collection of the necessary data. These procedures should include the creation of dialogues with the corporation's various stakeholder groups and the creation of dialogues within the corporation. It is imperative that the company develops a process that requires the creation of an actual dialogue between the corporation and its stakeholders and not simply a one-way survey.¹⁸⁹ A dialogue is necessary to understand how the stakeholders develop their opinions and what values are the basis of those opinions.¹⁹⁰ It is through this dialogue that the corporation will be able to think critically about its activities with direct feedback from its stakeholders.¹⁹¹

Third, the corporation must designate specific personnel to be responsible for the various stages of the social report process. This requires that all employees be educated about the social report process and their role in the process. In addition to educating the employees, all members of the organization must be kept up to date on the progress of the social report, including regular reports to top management and the board. Once a report is completed, procedures need to be in place to ensure that stakeholder feedback is provided to the relevant departments of the corporation.

3. Stakeholder-Oriented

There are several basic principles guiding what information must be included in the social report. The report must take into account the views of all stakeholders of the firm, not simply those stakeholders who are the most powerful or have the most influence over the corporation.¹⁹² The stakeholder groups of any company are likely to have diverging

reflexive law goals of institutionalizing into the decision-making process concern for all parties potentially affected by any corporate activity.

189. See Zadek et al., *supra* note 158, at 42. It is expected that the Internet may provide a useful and cost-effective way to assist in the creation of the dialogue.

190. Zadek states that "'Counting' in the traditional sense of polling people's views may work in choosing between different flavours of ice cream, but it rarely helps in understanding how people develop a sense of moral concern, and how this concern is voiced." Zadek, *supra* note 21, at 1427. For further discussion of the benefits of a dialogue process, see *infra* Part VII.B.

191. The necessity of creating a dialogue with stakeholders is dramatically seen in the case of Shell Oil's Brent Spar incident. SHELL INTERNATIONAL LTD., PROFITS AND PRINCIPLES—DOES THERE HAVE TO BE A CHOICE? 41 (1998); *Shell Oil Platform to Become a Pier*, HOUSTON CHRON., Jan. 30, 1998, at Business 1; *Greenpeace Admits Error Against Shell*, L.A. TIMES, Sept. 6, 1995, at D2. See also Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 J. L. & CONTEMP. PROBS. (forthcoming 1999); *Shell UK Limited, Shell Expro Brent Spar Web Site* (visited Sept. 9, 1999) <<http://www.shellexpro.brentspar.com>>. In 1995, Shell Oil proposed a deep sea dumping of an abandoned oil rig, the Brent Spar, in the North Sea. Various interest groups, including Greenpeace, made allegations—that were all later proven to be false—that the dumping would be an environmental disaster. This set off protests ranging from boycotts to violent attacks on Shell service stations in Germany. SHELL INTERNATIONAL LTD., *supra*, at 41. Due to these protests, Shell abandoned its dumping plans and began a dialogue with a variety of non-governmental interest groups that lasted over two years. *Id.* Through this dialogue process, Shell reached a solution to the problem (turning it into a quay, or pier, in Norway) that was acceptable to all. *Shell Oil Platform to Become a Pier, supra*, at Business 1. Shell has apparently learned the need for developing a dialogue and created its own social report in 1998. SHELL INTERNATIONAL LTD., *supra*. Included in this report are "Tell Shell" cards. *Id.* These cards ask readers of the report to send Shell their opinions on such issues as bribery, doing business in a developing company, and balancing shareholder value versus social investments. *Id.* If the writer requests, Shell will publish the writer's comments on its web site.

192. See Zadek et al., *supra* note 158, at 42 (discussing the quality principle of inclusivity).

views on many issues, and the social report must be able to handle this variety.¹⁹³ The firm must be prepared to consider the diversity of perspectives and to explain its actions to each of those stakeholder groups. Furthermore, legislation cannot allow a company to intentionally and systematically exclude certain aspects of its activities from the report.¹⁹⁴ Although the complexity of a corporation's situation may prevent the inclusion of all aspects of its business or the views of every stakeholder, the corporation must not be allowed to deliberately exclude activities that it would wish to remain secret.¹⁹⁵

Due to these concerns, social reports should be divided into sections based on different stakeholder groups. Requiring companies to prepare separate sections for each stakeholder group will force them to systematically consider how their actions are impacting each stakeholder group and how they are meeting the expectation of that group.¹⁹⁶ The common stakeholder groups that should be included are: customers; community (and society in general); employees; environment; franchisees; shareholders; and suppliers. These are very general categories, and may not apply to every firm. For example, many firms will not have franchisees. The informational requirements of each category can also vary greatly from industry to industry. For employees, issues of worker safety in the employee category will appear quite different in the social report of a financial services firm when compared to the report of a manufacturing firm.

Dividing the report into sections based on stakeholder groups does not imply that the issues relevant to one stakeholder group are of no concern to another stakeholder group. Quite the contrary, those issues may be vitally important. For example, a customer may refuse to purchase products from a company that treats its employees poorly in terms of safety or uses manufacturing procedures that are harmful to the environment. A brief sample of the issues for each category are presented below:

Customers: product safety and content (in general, and for specific groups, such as pregnant women); customer complaints or lawsuits brought against the company; restrictions on advertising to "vulnerable" groups; and customer

193. See *id.*

194. *Id.* at 42-43 (discussing the quality principle of completeness).

195. It may be the case that, as a practical matter, not every item of importance can be comprehensively covered by the firm in one annual report. *Id.* at 43. Although it may be appropriate to exclude some items from any one report, the firm must not be allowed to selectively exclude certain unfavorable items, and those items must be covered in subsequent reports.

196. The other possible organization of the social report is based upon separate categories. For example, one system uses five separate categories: community/political responsiveness (e.g., corporate giving, relationship with government agency); human investment (health and safety, minority workers); openness of the system (effective corporate governance, relations with the news media); consumer welfare (product safety, consumer complaints); and ecology/energy (pollution). FREDERICK D. STURDIVANT, *BUSINESS AND SOCIETY: A MANAGERIAL APPROACH* 65-66 (1985). The evaluation of the company's performance in these categories is then based upon their impact on the various stakeholder groups. *Id.* Similarly, the Council on Economic Priorities (an external social report) rates corporations based upon their performance in the categories of the environment, charitable giving, community outreach, women's advancement, minority advancement, family, workplace issues, and disclosure of information. See BENJAMIN HOLLISTER ET AL., *supra* note 16, at 8-13. The primary focus in those types of social reports is upon the issues, while the secondary focus is on the stakeholders. Here, the proposed social report legislation would require the focus to be upon the stakeholders. This is consistent with the social reporting philosophy described above of creating a dialogue with the stakeholders and focusing on the issues that they deem important. See *supra* text accompanying notes 189-191.

concerns about the trade-off between product or service price and environmental issues.

Community: charitable contributions and other charity activities; local employment; the environmental impact of the company's operations; political activity (such as lobbying activity and donations to political organizations); and regulatory compliance.

Employees: wages (compared to the industry and community standards); occupational health and safety; training; advancement; benefits (e.g., pensions, child care); gender and race issues; employee lawsuits; and work/family issues.

Environment: compliance with EPA standards; regulatory actions brought against the company; environmental goals and progress towards those goals; hazardous materials; waste reduction; and emissions.

Franchisees: general policies on issues such as termination and encroachment; lawsuits filed; training; and communications with the franchisor.

Shareholders: financial returns; accurate disclosure of business operations and performance; company investments; shareholder proxies; corporate governance; and executive compensation.

Suppliers: suppliers' social and environmental performance; litigation; and standards for selecting and monitoring suppliers.

The social report must also be in a form that allows both the corporation and its stakeholders to compare the corporation's performance to other corporations (who are in a similar situation), and allows all to observe the progress of the corporation's performance over time.¹⁹⁷ In some situations, externally created performance benchmarks may also be valuable. The overuse of such benchmarks, however, can result in problems similar to the problems with the overuse of substantive law.

4. Verification¹⁹⁸

An independent and accredited auditor must verify the social report. This will ensure that the report is a truthful and accurate assessment of the corporation's performance, and that the appropriate procedures and policies are in place and are being meaningfully followed. Verification will also allay the public's concern that the report is only a public relations campaign or marketing ploy that exaggerates the company's social performance and hides less desirable aspects of the company's activities.¹⁹⁹ A self-regulatory body under the supervision of the government should be responsible for accrediting the

197. See Zadek et al., *supra* note 158, at 42 (discussing the quality principle of comparability).

198. See *id.* at 44; Orts, *supra* note 8, at 1306-09 (discussing the verification requirements of the EMAS regulation); *Id.* at 1322-23 (discussing the need for verification in a proposed American environmental audit scheme).

199. Jorgen Giversen, former CEO of Sbn Bank in Denmark, argues, quite colorfully, that social reports will allow the public to determine if a corporation is living up to the values or practices it markets itself as having: "Ethical Accounting is not for softies or funks. It takes guts to hang your dirty linen in public and to walk your talk." Pruzan, *supra* note 159, at 64.

independent verifiers.²⁰⁰ Overall, the verification of social reports would be similar to the auditing of corporate financial statements, and the lessons learned there are very applicable to developing a system for accrediting independent verifiers for social reports.

5. Annual, Publicly Disclosed Social Report²⁰¹

The verified social report must be presented to the public in a document that is intelligible and not misleading. The report should state the basic findings of the social audit and management's evaluation and explanation of the company's performance.²⁰² In addition, management should be allowed to state any plans they may have for improving the company's social performance in the future.

Disclosure is a key requirement for providing information to the market.²⁰³ In this respect, social report legislation is a continuation of and expansion on the federal securities law theme of disclosure. Instead of stockholders deciding whether or not to invest in a corporation, however, it is stakeholders deciding whether or not to do business, or have any type of relationship, with the corporation. It is also expected that this information will be used by stakeholder groups to actually place pressure on corporations to bring their activities in line with public expectations.²⁰⁴ In this respect, disclosure of the social report helps to improve corporate behavior due to corporations' desire to avoid negative publicity.²⁰⁵

200. See Orts, *supra* note 8, at 1322 (arguing that within an environmental auditing regulatory system, auditors and verifiers should be allowed to develop self-regulation, with the government only intruding to assure that adequate standards of accreditation are developed and enforced). In addition, these verifiers should only face liability for fraud or gross negligence, and not simple negligence. See *id.* at 1307, 1322-23 (discussing the standard for environmental auditor/verifiers and providing cites to analyses of accountant's liability for negligence).

201. See Zadek et al., *supra* note 158, at 43-44; Orts, *supra* note 8, at 1305-06 (discussing the disclosure requirements of the EMAS regulation); *Id.* at 1323-24 (discussing the disclosure requirements for a proposed American environmental audit scheme).

202. In essence, management will be required to justify its actions. As stated in the introductory quotation to this article from Thomas Donaldson, "justifying one's acts, most ethicists would grant, is the first step toward improving one's behavior." DONALDSON, *supra* note 2, at 204. This is similar to Stone's claim that a morally responsible person must be able to justify their actions if called upon to do so. See *supra* Part III.A (discussing Stone's notion of a responsible corporation as analogous to a responsible person).

203. See Orts, *supra* note 8, at 1312 (quoting Louis Loss's statement that the securities laws have a theme of "disclosure, again disclosure, and still more disclosure"). In 1980, a staff report of the Securities and Exchange Commission considered the disclosure of socially significant information in annual reports or proxy statements, but rejected such a proposal because: "To overlay the securities disclosure system with a web of information primarily of interest to the public generally or to non-investor constituencies [sic] could jeopardize the efficient functioning of the securities disclosure process." STAFF REPORT, *supra* note 28, at 322. The report noted, however, that if Congress believed such information is significant to society, then "any system for disclosing corporate social information to the public generally should be separate and apart from the securities disclosure system." *Id.* at 323.

204. See *supra* Part I (discussing the pressure consumer and other public interest groups place on corporations to conform to their views of appropriate corporate behavior).

205. The power of a corporation's motivation to avoid bad publicity should not be underestimated. In 1986, Congress required manufacturers to make public the quantities of certain chemicals (approximately 300 in all) emitted into the air each year. Mary Beth Regan, *An Embarrassment of Clean Air*, BUS. WK., May 31, 1993, at 34. Between 1987 and 1991, chemical makers (which create the largest share of emissions) reduced their

The primary purpose of disclosing a social report is not as a means for the public to identify "bad" corporations. Public disclosure is a necessary part of the creation of a dialogue between the corporation and its stakeholders. The corporation should not view disclosure as a mere formality, but as an important part of the communication process. After viewing the report, stakeholders are able to provide the company with feedback on which practices it favors and which practices it would like to see changed. This feedback then starts the next cycle of the social reporting process.

Once the reporting requirement becomes mandatory, there should be penalties for false or misleading information in a social report, though clearly with a standard higher than negligence. In addition to governmental agency oversight, private enforcement of the reporting standards should also be given serious consideration.²⁰⁶

VI. CORPORATE SOCIAL REPORTS: TWO EXAMPLES

The Body Shop International (The Body Shop) of the United Kingdom and Ben & Jerry's Homemade, Inc. (Ben & Jerry's), of the United States have received the most publicity for their social reports.²⁰⁷ This section provides brief descriptions of their social reports and how they are conducted to demonstrate how the above requirements work in practice.²⁰⁸

A. The Body Shop

The Body Shop is a retailer and franchisor in the health and beauty aids industry. In 1995, The Body Shop had total retail sales of \$800 million from over 1200 stores worldwide.²⁰⁹ The company employed over 3300 persons in 1995 and its 572 independent franchisees employed several thousand more persons.²¹⁰ Beginning in 1992, The Body Shop began publishing independently verified environmental statements.²¹¹ In 1995, The Body Shop published its first social report, entitled *The Values Report 1995*.²¹² As a supplement to this internal evaluation, Kirk Hanson, a senior lecturer at the Stanford School of Business, conducted an independent evaluation of the company during 1994 and 1995.²¹³

To prepare the independent report, Hanson interviewed franchisees, suppliers, community activists, journalists, and industry specialists.²¹⁴ Hanson also spent a

emissions by 35%. *Id.* However, it should be noted that some of this reduction might have been due to changes in the requirements regarding what types of emissions must be made public. *Id.*

206. See Orts, *supra* note 8, at 1323-24.

207. Zadek et al.'s book provides chapters from a variety of different companies, mostly European, that have experience creating social reports. BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13.

208. For a description of other practices and the philosophies of these companies, see Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment*, 50 WASH. & LEE L. REV. 1625 (1993).

209. Kirk O. Hanson, *The Body Shop International Social Evaluation 1995* (on file with author).

210. *Id.*

211. Maria Sillanpää & David Wheeler, *Integrated Ethical Auditing: The Body Shop International, UK*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 103.

212. Hanson, *supra* note 209.

213. *Id.*

214. *Id.* Hanson interviewed approximately 300 people altogether. *Id.*

significant amount of time at the company headquarters, reviewed public and internal documents, and made several unannounced visits to company stores.²¹⁵ The final evaluation compared The Body Shop's performance to its own values statement, to its claimed social performance, against "comparable" companies, and against what were believed to be the most outstanding companies ("best practices") in terms of social performance. The final report was based on 39 dimensions that were divided into the categories shown in Table 1.

TABLE 1: CATEGORIES OF THE BODY SHOP'S 1995 SOCIAL REPORT

1. Company Values and Mission
2. Relations with Shareholders
3. Relations with Customers
4. Relations with Employees
5. Relations with Franchisees
6. Relations with Suppliers
7. Trading With Communities in Need
8. Concern for Environment
9. Relations With Community
10. Relations With Public
11. Contributions to Social Change

As an example, the category of "relations with employees" is divided into the dimensions of wages and benefits, human resources policies, opportunities for women, racial diversity, commitment to employees and their careers, work/family balance and policies, and worker safety.²¹⁶ For each of these dimensions, Hanson gave the company a rating of one to five stars, based on how well it measured up to "comparable" companies.²¹⁷ The ratings were based on the company's actual practices, as determined by Hanson.²¹⁸

In 1997, The Body Shop expanded its auditing approach and produced *Values Report 1997*, a 200-page report detailing the company's performance in nine stakeholder categories.²¹⁹ For the social report of 1997, The Body Shop followed a methodology consistent with the requirements discussed above²²⁰ and was much more expansive than the company's prior report. The report was developed by the staff of the Ethical Audit Department of The Body Shop, which was established solely for the purpose of managing

215. *Id.*

216. Hanson, *supra* note 209.

217. The one to five scale ranked one and two stars as below average, three stars as average, and four or five stars as being above average. *Id.*

218. *Id.*

219. See *infra* Table 2.

220. THE BODY SHOP APPROACH TO ETHICAL AUDITING 16-17 (Jan. 1998), available at <<http://www.bodyshop.co.uk/aboutus/values.html>> [hereinafter BODY SHOP APPROACH]. The methodology of The Body Shop's social audit was developed with the help of the New Economics Foundation, which is headed by Simon Zadek, and explicitly adopted Zadek's eight principles of quality. *Id.* See also *supra* note 179 (listing the eight principles of quality).

the audit process.²²¹ The process of creating *Values Report 1997* began with a review of policies against which performance would be judged.²²² The policy review included the company's mission statement,²²³ health and safety guidelines, human resources policies, and fair trade program.²²⁴ During the social report process, these policies would be updated to reflect the most current information.²²⁵

TABLE 2: VALUES REPORT 1997 STAKEHOLDER CATEGORIES

1. Employees
2. International Head Franchisees
3. UK Franchisees
4. Customers
5. Suppliers
6. Shareholders
7. Community Involvement
8. Environment
9. Animal Protection

The next step required setting the scope of the report.²²⁶ This step involved the determination of which stakeholders may affect or can be affected by the company.²²⁷ For international companies such as The Body Shop, this also includes a decision regarding to what extent can stakeholders from all of the countries in which the company

221. Sillanpää & Wheeler, *supra* note 211, at 110. The Ethical Audit Department is usually not responsible for the day-to-day management of ethical issues within the company. *Id.* at 112.

222. BODY SHOP APPROACH, *supra* note 220, at 19.

223. The Body Shop's mission statement states that company's "reason for being" is:

To dedicate our business to the pursuit of social and environmental change.

To creatively balance the financial and human needs of our stakeholders: employees, customers, franchisees, suppliers and shareholders.

To courageously ensure that our business is ecologically sustainable: meeting the needs of the present without compromising the future.

To meaningfully contribute to local, national and international communities in which we trade, by adopting a code of conduct which ensures care, honesty, fairness and respect.

To passionately campaign for the protection of the environment, human and civil rights, and against animal testing within the cosmetics and toiletries industry.

To tirelessly work to narrow the gap between principle and practice, whilst making fun, passion and care part of our daily lives.

THE BODY SHOP VALUES REPORT 1997 (1998), at inside cover, available at <<http://www.bodysshop.co.uk/aboutus/values.html>> [hereinafter VALUES REPORT].

224. BODY SHOP APPROACH, *supra* note 220, at 19.

225. *Id.*

226. The Body Shop's social report was limited to human stakeholders, as it had separate procedures in place to consider environmental performance and animal protection. *Id.* at 19. This essentially created three separate reports within the values report: the social report; the environmental report; and the animal protection report. For purposes of this article, however, all three sections would be considered a single "social report."

227. *Id.*

conducts business be included in the audit process. Practical reasons will have a definite impact on setting the scope of the report.

Next, the company must agree which performance indicators to use.²²⁸ The Body Shop used three performance indicators.²²⁹ First, performance should be measured against internal and external benchmarks.²³⁰ Internal benchmarks are individual standards set by the company and its various departments.²³¹ External benchmarks are based on the "best practices" of other companies (to the extent such practices are known²³²) and standards set by government agencies, professional entities, or special interest groups.²³³ Second, performance should be measured against the company's core values, such as its mission statement.²³⁴ The core values are created by The Body Shop, but the company consults stakeholders as to their opinion of how well the company is meeting its stated values.²³⁵ Third, performance should be measured against stakeholders' perception of how well the company is meeting their specific needs and expectations.²³⁶ These needs and expectations are identified through dialogues with the stakeholders.²³⁷

After the performance indicators are adopted, the company begins its stakeholder consultation.²³⁸ Actual dialogues with the company's stakeholders are needed to identify the relevant issues for each stakeholder group, which are then followed by larger-scale surveys.²³⁹ The Body Shop used focus groups to allow face-to-face conversations with representatives of the various stakeholder groups and an open discussion about their needs and concerns.²⁴⁰ The Body Shop also felt it was important to open up these focus groups to the external verifiers.²⁴¹ From the focus groups, the audit staff could identify the important issues for each stakeholder group and use this information to develop surveys to be given to a larger number of the members of each stakeholder group.²⁴² The surveys were administered to the largest sample size practical, with respondents completing the surveys anonymously.²⁴³ In addition to the surveys, The Body Shop gained information from company departments that compiled quantitative and qualitative

228. *Id.* at 20.

229. BODY SHOP APPROACH, *supra* note 220, at 20-21.

230. *Id.* at 21.

231. *Id.*

232. *Id.* at 20.

233. Sillanpää & Wheeler, *supra* note 211, at 119.

234. BODY SHOP APPROACH, *supra* note 220, at 21. For the text of the mission statement, see *supra* note 223.

235. BODY SHOP APPROACH, *supra* note 220, at 21.

236. *Id.*

237. *Id.*

238. *Id.*

239. Sillanpää & Wheeler, *supra* note 211, at 120.

240. *Id.*

241. The independent verifier may even be used as a facilitator in some cases. *Id.* However, precautions must be taken to ensure the verifier does not become too involved to be objective. *Id.* at 124.

242. *Id.* at 120.

243. Sillanpää & Wheeler, *supra* note 211, at 120. An independent survey organization was used to ensure confidentiality. The organization collected the surveys and provided The Body Shop only with the statistical information and lists of comments. *Id.*

reports on their progress towards performance standards, and from confidential interviews with the management and staff.²⁴⁴

After the data collection, The Body Shop attempted to present this information in a way that was informative, as well as user-friendly. This was done by dividing the report into chapters based on stakeholder groups.²⁴⁵ Each chapter of the *Values Report* was essentially its own self-contained report. For each stakeholder group, the report stated the company's aims with respect to that stakeholder, how information was collected, the results of the consultations and surveys, standards of performance and results, the company's reaction to the audit results, and a recognition of where progress has been made and where it is needed.²⁴⁶

An example of The Body Shop's treatment of a stakeholder group in the *Values Report* is the chapter on "customers." The company's aims regarding customers involves achieving "commercial success by meeting our customers' needs through the provision of high quality, good value products with exceptional service and relevant information which enables customers to make informed and responsible choices."²⁴⁷ To get a full sense of the range of opinions on The Body Shop products and the expectations of consumers, the sample of customers included current users as well as lapsed users (those who had purchased a Body Shop product, but not within the last twelve months) and non-users.²⁴⁸ Through surveys and interviews with customers in the various countries where The Body Shop has stores, information was obtained (and presented to all stakeholders through the report based on user and non-user status) on the public's awareness of campaigns in which The Body Shop is involved, the general social concerns of customers, and attributes associated with the company.²⁴⁹ The report also provided information on customers' rankings of the importance of various attributes of cosmetics products in general (e.g., efficiency, environmental friendliness, price, and so forth) and whether The Body Shop's products were associated with those attributes.²⁵⁰ The report also stated the company's targets on environmental matters concerning consumers (e.g., the "refillability" and "recyclability" of products) and its progress towards those goals.²⁵¹

Overall, this chapter of the *Values Report* provides the company with information on what customers find important and what their expectations are. Also, it provides the customers with information on what the company values and what it is attempting to achieve (in relation to customers and in relation to other stakeholders). Information in the other chapters of the report are also of value to the consumer stakeholder group. For example, the chapter on the supplier stakeholder group discusses the company's efforts in encouraging its suppliers to meet certain standards regarding environmental matters²⁵² and the company's commitment to trading with "communities in need."²⁵³ Such

244. *Id.* at 121; BODY SHOP APPROACH, *supra* note 220, at 23.

245. See *supra* Table 2 for the stakeholder groups.

246. BODY SHOP APPROACH, *supra* note 220, at 23-24.

247. VALUES REPORT, *supra* note 223, at 106.

248. *Id.* at 108.

249. *Id.* at 110-13.

250. *Id.* at 113-14.

251. *Id.* at 115-17.

252. VALUES REPORT, *supra* note 223, at 129-31.

253. *Id.* at 134-43.

information will be very valuable to many consumers when considering The Body Shop's products. More importantly, this information provides feedback from a population of consumers that permits the company to understand what that stakeholder group expects from The Body Shop.²⁵⁴

Thus, the publication of the *Values Report* begins the dialogue and the social report process all over again, with the next audit building on the feedback from the current audit.²⁵⁵ In addition to improving the audit process, the report should also encourage dialogues between the stakeholder groups and the departments who deal with those stakeholders on a day-to-day basis.²⁵⁶ This requires all levels of the firm's hierarchy to reflect on their practices and work with the stakeholders to implement beneficial changes in the corporation's actions, as well as avoiding wrongful actions.

B. Ben & Jerry's Homemade, Inc.

Ben & Jerry's is a premium ice cream maker and ice cream parlor chain.²⁵⁷ It is a public corporation with annual sales around \$165 million.²⁵⁸ The company employs approximately 700 people and has three plants and 130 parlors, which are primarily in the United States.²⁵⁹ Ben & Jerry's has conducted some type of social report since 1988.²⁶⁰ These social reports began as analyses issued by independent reviewers and then gradually moved to their current form, an externally-verified internal audit.²⁶¹ The current approach is not just the assessment of the company from an outsider's perspective, but an attempt to develop standards against which the company can measure itself.²⁶² Similar to The Body Shop, Ben & Jerry's divided its social report into separate sections for each stakeholder group.²⁶³

254. It is important to remember that each stakeholder group is not just concerned about their own well-being. Take, for example, the consumer boycott behavior discussed above or the protests against Nike for the treatment of workers in its subcontractors' Asian factories. See *supra* notes 21-22 and accompanying text. In these examples, certain stakeholder groups, be they consumers or interest groups, tried to use whatever power they had to achieve meaningful change in what they perceived to be wrongful corporate behavior.

255. Sillanpää & Wheeler, *supra* note 211, at 124; see also *VALUES REPORT*, *supra* note 223, at 116 (presenting a diagram demonstrating the cyclical nature of the social audit process).

256. See *VALUES REPORT*, *supra* note 223, at 124.

257. Ben & Jerry's is a company that prides and markets itself on its strong sense of social responsibility. The company has a three-part mission statement. First, they state a product mission: "To make, distribute, and sell the finest quality all-natural ice cream and related products in a wide variety of innovative flavors made from Vermont Dairy Products." *BEN AND JERRY'S ANNUAL REPORT 1997*, at 7. Second, Ben & Jerry's have a social mission: "To operate the company in a way that actively recognizes the central role that business plays in the structure of society by initiating innovative ways to improve the quality of life of a broad community, local, national and international." *Id.* Third, there is an economic mission: "To operate the company on a sound financial basis of profitable growth, increasing value for our shareholders and creating career opportunities and financial rewards for our employees." *Id.*

258. *Id.* at 6.

259. John Willman, *Large Scoops of Social Values*, *FIN. TIMES*, Feb. 1998, at 8.

260. Alan Parker, *The Expert View: Ben & Jerry's Homemade, Inc., USA*, in *BUILDING CORPORATE ACCOUNTABILITY*, *supra* note 13, at 129.

261. See *id.* at 133-41.

262. *Ben & Jerry's 1995 Social Report, Audit Verifier's Report* (visited Sept. 9, 1999) <<http://www.benjerrys.com/fin/an95/social-audit/95socrep10.html>> [hereinafter *Ben & Jerry's 10*].

263. See *infra* Table 3. The following discussion is based on Ben & Jerry's 1995 social report because this report provides a better description of their auditing process than later reports.

TABLE 3: BEN & JERRY'S STAKEHOLDER GROUPS

1. Staff
2. Franchisees
3. Community
4. Suppliers
5. Customers
6. Stockholders
7. Environment

Ben & Jerry's report process begins with the stakeholder dialogue. For example, for the staff, full surveys are undertaken every other year, with focus groups in the interim years.²⁶⁴ The focus groups are held for each business site for both management and non-management employees.²⁶⁵ For the other stakeholder groups, such as franchisees, customers, and suppliers, Ben & Jerry's currently relies mostly on surveys but plans to engage in focus groups in the future.²⁶⁶ The outcome of the stakeholder dialogues are compared to performance indicators that are developed internally and also to external benchmarks.²⁶⁷ In each report, Ben & Jerry's plans to include data from past social reports to show its progress towards the benchmarks.

The social report process also includes an advisory group to review the company's process and an external verifier's report.²⁶⁸ The verifier's report comments on the matters included in the report, as well as matters excluded.²⁶⁹ Finally, the report contains a management summary.²⁷⁰ This summary comments on the results, as well as making commitments against which future performance will be assessed.

One stakeholder group represented in the social report is the section on the "staff."²⁷¹ The social report on this stakeholder group begins by providing a short profile of the company's employees, including the mix of men, women, and minorities in the various positions in the company, and the pay differentials, if any, between these groups.²⁷² The report also lists the ratio between the highest and lowest salaries²⁷³ and the company's entry-level, hourly wage compared to Ben & Jerry's home state of Vermont as a whole.²⁷⁴ This section also presents the number of employees receiving safety training and the incidences of injuries.²⁷⁵

264. *Ben & Jerry's 10*, *supra* note 262.

265. In 1996, the focus groups included 85 out of 703 employees, or 12% of the staff. *Ben & Jerry's 1995 Social Report* (visited Sept. 9, 1999) <<http://lib.benjerry.com/fin/an95/social-audit/95socrep2.html>> [hereinafter *Ben & Jerry's 2*]. The social report divided the discussions of the focus groups into the following topics: values and practices; training and advancement; and effectiveness of organization. *Id.*

266. *Id.*

267. *Ben & Jerry's 1995 Social Report* (visited Sept. 9, 1999) <<http://lib.benjerry.com/fin/an95/social-audit/95socrep1.html>> [hereinafter *Ben & Jerry's 1*].

268. *Id.*

269. *Id.*

270. *Id.*

271. *Id.* *Ben & Jerry's 10*, *supra* note 262.

272. *Ben & Jerry's 2*, *supra* note 265.

273. The report includes the ratios both with and without the value of stock options included. *Id.*

274. *Id.*

275. *Id.*

After these summary statistics, the report moves into a discussion of the issues raised in the focus groups. Overall, the auditors find that the employees have pride in their company and are generally satisfied with their compensation compared to past jobs.²⁷⁶ The employees are especially proud of the company's commitment to local and national social causes, but are concerned that these causes are threatened by financial matters.²⁷⁷ A common concern was the lack of opportunity for advancement (such as the hiring of management from outside the company rather than promoting current employees), which results in a disincentive to obtain further training.²⁷⁸

The management summary expressed concern about what was thought to be lowered morale throughout the year.²⁷⁹ Management also committed itself to a more informative method of measuring the company's safety performance and to fully assess the company's training programs.²⁸⁰ The audit verifier's report raised several key matters that concern the staff and should be improved upon in the future.²⁸¹ First, the auditor states that the company notes many staff issues that are problematic, but does not communicate an explicit set of policies and procedures for handling these issues.²⁸² In addition, a systematic way to measure progress in this area is needed.²⁸³ Second, the company has not determined the extent to which the staff understands the policies, intentions, and procedures behind the social report.²⁸⁴

Overall, Ben & Jerry's is making progress towards understanding the concerns and expectations of its stakeholders. Although it has not implemented the stakeholder dialogue process as completely as The Body Shop, it is moving in that direction by supplementing its surveys of the various stakeholder groups through the use of field consultants to meet with the stakeholders.²⁸⁵ For the franchisee stakeholder group, this process allowed Ben & Jerry's to realize that many franchisees were concerned with the level of commitment the company had shown towards the franchise program.²⁸⁶ The report also presents information and quotes obtained from franchises in sections dealing with issues such as franchisees' perceptions of Ben & Jerry's social mission and matters franchisees would and would not like changed about their relationship with the company.²⁸⁷ Thus, the social report has provided the means for the company to understand the expectations of its various stakeholders and vice versa. In addition, future editions of the report will allow the company and stakeholders to measure the company's

276. *Id.*

277. *Ben & Jerry's 2, supra* note 265.

278. *Id.*

279. *Id.*

280. *Id.*

281. *Ben & Jerry's 10, supra* note 262.

282. *Id.*

283. *Id.*

284. *Id.*

285. For example, in 1995, there were 337 visits to franchise shops by field consultants. *Ben & Jerry's 1995 Social Report* (visited Sept. 9, 1999) <<http://lib.benjerry.com/fin/an95/social-audit/95socrep3.html>> [hereinafter *Ben & Jerry's 3*].

286. Among other things, Ben & Jerry's had gone several months without a permanent Director of Retail Operations, which is the department in charge of managing franchisee relations. *Id.* The company was just starting to gather the information it needed to begin conducting a survey in areas such as suppliers and the local community. *Id.*

287. *Id.*

progress towards meeting those expectations and to determine how those expectations change over time.

VII. ARGUMENTS FOR AND AGAINST SOCIAL REPORT LEGISLATION

A. Arguments Against Social Report Legislation²⁸⁸

It is expected that many corporations will be resistant to the adoption of social reporting legislation. The most likely arguments against social reports are considered below.

Many corporations may be resistant to social reports because they do not want to be labeled as "good" or "evil." Corporations do not want an external body to come in and publicly pronounce them to be a "bad" organization based on some universally applied standard of proper behavior. As stated previously, however, social report legislation only requires that corporations conduct the social report in a meaningful manner.²⁸⁹ The public and the corporation's stakeholders will develop their own opinions of the corporation based on the disclosed information, but there will be no official declaration from the State on the ethical goodness of the corporation. It is expected that many interest groups will use the information to publish their own opinions or rankings of the corporations based on issues of interest to them. The corporation's social report, however, will ensure that this information is accurate and will provide the full picture of the corporation's situation.²⁹⁰ Corporations also may be reluctant to disclose information that will cast them in an unfavorable light, even if the report does not make a judgment on the company. However, because this information is bound to be discovered by the public or the company's stakeholders, it is better for the company to be able to proactively manage the disclosure of that information and how it plans to deal with the matter or to justify its actions.²⁹¹

Many corporations may also argue that the process of creating and distributing the social report will be too costly and time consuming. However, a substantial amount of the work necessary to complete the social report is already being done by many corporations. Corporations are already required by law to collect some of the information, such as in OSHA reports and EEOC reports. In addition, many corporations already do voluntary information gathering for their own benefit, such as environmental audits or workplace

288. Alan Parker provided significant help in identifying several of the issues in this section. Telephone Interview with Alan Parker, former director of social accounting for Ben & Jerry's Homemade, Inc., and founder of SAAR Associates (Apr. 1998).

289. See *supra* Part V.A.

290. For example, in Ben & Jerry's first social report, the auditor criticized the company for having very few minority employees. Parker, *supra* note 260, at 133. In the social report, Ben & Jerry's was able to say that the state they were operating in, Vermont, had an extremely small minority population, and though they were attempting to "expand the pool of applicants to include more minorities," their main task was "to meet the employment needs of the region where we live and work." *Id.*

291. Justifying one's actions can serve two purposes. First, as stated in the opening quotation to this article from Thomas Donaldson, *supra* note 2 and accompanying text, and discussed in connection with Christopher Stone's notion of social responsibility, *supra* note 3 and accompanying text, justifying one's actions is a first step towards improving one's behavior. Second, disclosure of the reasons behind an action allows the company's stakeholders to understand why the corporation behaved in certain ways, and can lead to a dialogue about the ways the company can improve its behavior based on those reasons.

surveys. The data from these various sources simply needs to be brought together in a single report²⁹² and collected in a systematic, coordinated fashion. This is not to say that there will not be significant costs in both getting started in the process and then in continually collecting the necessary information. These costs are unknown, however, and clearly need to be considered in the initial, experimental stage of developing social reporting requirements. Once these costs are more clearly understood, a more useful cost-benefit analysis can be performed.

From a corporate strategy perspective, the costs of creating a social report may not be considered costs at all, but rather an investment with returns paid in several different forms. First, the corporation will benefit from stronger relationships with critical suppliers, customers, and employees.²⁹³ Second, the corporation will have a better understanding of any potential legal liability it may face, either from failure to comply with government regulations or from civil lawsuits (e.g., sexual harassment).²⁹⁴ Third, the long-term survival and profitability of the company is dependent upon understanding and meeting the expectations of consumers, as well as other members of the general public.²⁹⁵ The costs may also be justified in part on the basis of the information requirements of the market. As stated earlier,²⁹⁶ more and more investors are using social screens. This information is vital to their investment practices, but costly for them to obtain. In the end, however, the strongest argument may be that the benefits accruing to society from a social reporting requirement would certainly justify these costs.²⁹⁷

B. *The Benefits of Social Reports as Reflexive Law*

A social report meeting the requirements listed above will provide many benefits as a reflexive law regulatory scheme, and will positively impact the day-to-day functioning of the corporation. First, a social report promotes improved and informed corporate

292. Rob Gray of the Centre for Environmental and Social Accountancy has created what he calls a "silent account" from the social information that corporations place in their annual reports. Rob Gray, *The Practice of Silent Accounting*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 201, 201-17. Gray took Glaxo Holdings PLC's 1994 annual report and produced a social report covering such issues as the company's mission and policy and the company's impact on the community, environment, customers and employees. *Id.* at 205.

293. For example, by creating a dialogue with stakeholders, the social reporting process increases the level of trust these stakeholders have in the corporation. See generally Symposium, *Special Topic Forum on Trust In and Between Organizations*, 23 ACAD. MGMT. REV. 3 (1998) (presenting various theories on the determinants of trust and its importance to organizations).

294. Similar to the leniency given to corporations that disclose environmental violations and demonstrate that measures are being taken to correct the situation, commentators may consider giving leniency to corporations for matters they disclose.

295. See Dunfee, *supra* note 191.

296. See *supra* text accompanying note 20 (stating that approximately nine percent of all professionally managed investments are social screened).

297. The Sbn Bank's first social report stated that social auditing "demonstrates that there are other values to be promoted than power and money. The Ethical Accounting Statement measures the degree to which the company lives up to these shared values and thus supplements the financial statement's bottom line." Pruzan, *supra* note 159, at 81. Peter Pruzan argues that most arguments against social reporting are not really arguments. Instead, "what we are talking about is introducing a new perspective on organizational identity and success." Author email correspondence with Peter Pruzan, Professor at the Copenhagen Business School, Copenhagen, Denmark (May 1998).

decision-making. David Messick and Max Bazerman have stated that "[e]xecutives who make higher-quality decisions will tend to avoid ethical mistakes. Improving the quality of decision making means ensuring that all the consequences of actions are considered."²⁹⁸ A social report creates higher-quality decisions by providing managers with the information necessary to understand the full impact of any corporate action. This is similar to the National Environmental Policy Act's requirement that federal agencies prepare an impact statement before taking any actions that may have a significant impact on the environment. These procedural requirements are expected to affect the quality of the substantive decisions made.²⁹⁹ Furthermore, a social report encourages a company to "understand whether there are practical options for improving on their social performance in ways that will not harm their business performance and in many ways can improve it."³⁰⁰

Benefits from improved information will affect the corporation at all levels of the hierarchy, not just the board of directors or top management. The various departments of the corporation deal with one or more stakeholder groups on a daily basis,³⁰¹ which is quite different from the board of directors, which acts only in an overseer role. The involvement of the lower levels of the hierarchy in the dialogues creating and reviewing the social reports allows all employees to understand how their actions impact stakeholders and the norms they are expected to work within.

Second, social reports improve a corporation's understanding of stakeholder and community expectations. ISCT tells us that a community's norms determine what is responsible corporate behavior for that community.³⁰² A full understanding of these norms and expectations is necessary before any manager can meaningfully attempt to apply ISCT. Furthermore, in the absence of a dominant norm, the entire relevant community should be involved in determining what the appropriate norm should be. The transfer of information in the dialogue process (discussed next) can promote the determination of such norms by opening communication channels between stakeholders and the corporation.

Although a social report gives the corporation a better understanding of its stakeholders' expectations, it also gives the stakeholders a better understanding of the reasons behind the corporation's behavior. The dialogue required to create a social report and the disclosure of the report to the public transfers information in a variety of directions: from the stakeholders to the corporation; from the corporation to the stakeholders; and from stakeholder to stakeholder.³⁰³ Providing information to stakeholders develops their trust because they can see if their concerns are being addressed. As anecdotal evidence, David Messick and Max Bazerman provide the

298. David M. Messick & Max H. Bazerman, *Ethical Leadership and the Psychology of Decision Making*, 37 SLOAN MGMT. REV. 9, 20 (1996).

299. Orts, *supra* note 9, at 785.

300. Zadek et al., *supra* note 13, at 29.

301. See *supra* text accompanying notes 238-244 (discussing The Body Shop's goal of encouraging dialogues between stakeholders and the company departments that deal with them).

302. See *supra* text accompanying notes 129-132.

303. It is important to note that corporations can often be each other's stakeholders. For example, a supplier requires a customer, and each is a stakeholder of the other.

example of two similar construction projects in Arizona.³⁰⁴ One company worked with the community and gained its support, and met with success.³⁰⁵ The other company, however, ignored community environmental groups and, as a result, faced such problems as legal challenges to its actions.³⁰⁶

Transferring information between stakeholders is also necessary, as various stakeholder groups will often have conflicting views. Through the social report, the various stakeholder groups can see where their expectations match one another, and where they are in competition.³⁰⁷ By understanding each other's perspective, the stakeholders can work on their points of disagreement.³⁰⁸ In fact, the social report creates a process whereby stakeholders and the corporation can develop norms of appropriate behavior that reflect agreed-upon trade-offs between all the parties' interests. Thus, even though the corporation has the final say in disputes between stakeholders,³⁰⁹ the social report permits stakeholders to understand, and perhaps generally agree with *why* a corporation has acted, rather than simply focusing on *what* the corporation did.³¹⁰

Third, public disclosure of the social report promotes corporate accountability. Stakeholders may often believe that corporations' claims of ethical behavior are mere marketing ploys. With the public disclosure of an externally-verified social report, however, stakeholders can actually evaluate these claims.³¹¹ Disclosure requires corporations to stand behind their actions and give justifications for what they have done. Furthermore, making social reports public gives governments and special interest groups the opportunity to examine the current state of the business world and emerging trends in business practices, and attempt to influence the development of these norms as they see fit.

Finally, as a reflexive law, social report legislation avoids substantive law's main problems in the area of corporate social responsibility discussed above,³¹² and helps alleviate those problems. Social reports avoid the juridification problem by using standards that are easily adaptable to each industry's or corporation's unique situation, as opposed to detailed standards that attempt to cover every possible situation in a fair manner, and essentially rely on self-regulation. Reflexive law is not reactive, because it relies on corporations obtaining the most current information possible and constantly

304. Messick & Bazerman, *supra* note 298, at 21.

305. *Id.*

306. *Id.*

307. Telephone interview with Alan Parker of SAAR Associates, *supra* note 288.

308. Richard Evans, *Accounting for Ethics: Traidcraft plc, UK*, in BUILDING CORPORATE ACCOUNTABILITY, *supra* note 13, at 87.

309. ISCT and its discussion on priority rules for deciding between authentic, legitimate norms provides considerable guidance for management in situations of conflicting stakeholder demands. See DONALDSON & DUNFEE, *supra* note 30, at 250-62.

310. Zadek et al., *supra* note 13, at 13 (discussing the benefits of social reports in transferring information between stakeholder groups); see also Thomas Jones & Leonard Goldberg, *Governing the Large Corporation: More Arguments for Public Directors*, 7 ACAD. MGMT. REV. 603, 604-05 (1982) (arguing that due to the conflicting interests between the many corporate constituencies, improved social responsibility can be judged in terms of "greater procedural fairness rather than substantive fairness"); *supra* notes 94-102 and accompanying text (presenting Stone's view of social responsibility and the need for a responsible corporation to be able to justify their actions if called upon to do so).

311. See Zadek, *supra* note 21, at 1427-28.

312. See *supra* Part III.A.

rethinking their practices in light of that information. Reflexive law avoids the legitimacy problem by its decentralized nature. The parties most clearly affected by any corporate action are the ones with the voice to speak out against any unfavorable act. Lastly, society's values do not need to be framed into a universally applicable law. The social report provides the mechanism whereby the norms of society's various communities are made clear to all members of the communities. This allows both the corporation and its stakeholders to evaluate how well the corporation is meeting society's expectations and norms over time.

VIII. CONCLUSION

Producing socially responsible corporations is an extremely arduous task for the law. This task is made all the more difficult by the value pluralism in society. The emergence of reflexive law in response to our highly differentiated society, however, provides an approach that is suited for the task at hand. The goal is not to create more and more substantive legal obligations for corporations to comply with, but to instead make corporations responsive to the demands and expectations of society. ISCT provides a framework for understanding that economic communities should be free to establish their own norms of appropriate behavior (within certain bounds) and to expect corporations to live up to those norms. Social reports, as a reflexive law, encourage corporations to better understand the expectations of their economic communities and the impact of their actions on that community. By creating social reports, corporations will systematically consider new ways of improving their social performance. With public disclosure, corporations will also become accountable to the public. Moreover, the burden of producing socially responsible corporations is no longer fully on the state, but is shared by business and other social institutions. Social reports provide a viable manner of encouraging corporations to understand and respond proactively to society's varied expectations and demands, which is the definition of a socially responsive corporation.