Corporate social responsibility as the duty of directors

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Abstract

In the paper, we will try to reveal legal incentives and obstacles to the implementation of the concept of corporate social responsibility in Slovenia, the EU and globally. Corporate social responsibility are legally analysed as directors' duty and responsibility. In addition, some of the existing legal tools as non-financial and due diligence reporting, according to EU law and national legislation are evaluated.

We try to present legal tools for bridging the gap between numerous international proclamations, political and legal acts on the one hand (Global Compact and other UN act, Tripartite MOD Declaration on Multinational Enterprises, OECD Guidelines for Multinational Corporations, UN guidelines for respecting human rights in the economy), and the reality of implementing the idea of corporate social responsibility in real business life.

Despite the fact that EU corporate social responsibility considers companies to be responsible for their impacts on the social and natural environment (renewed strategy EU Communication 2011), EU corporate law in the past has not followed this concept. The so-called voluntary approach in which corporate directors were expected, without sanction, to include sustainability goals in business strategies and business operations was not enough.

The corporation's only duty was to report it publicly, exposing itself to its consumers and the general public. Such a voluntary approach cannot yield results in the long run, so new directives in the EU and member states have been considered. The case of Slovenia is presented (Legislation of the Republic of Slovenia on corporate social responsibility: implementation of the directive on non-financial reporting in ZGD-1, the obligation to observe EU social, labour and environmental law and national strategic and political documents, which follow slowly to EU directions in the field of sustainability and social responsibility.

Keywords: social responsibility, sustainability, legislation, manager, dusty, business
1 Introduction

Directors' duties and responsibilities are defined differently in legal orders. They can be specified in great detail, such as in the UK, or not at all, as e.g. in Germany or in Slovenia, where the law defines the duty of care only as a legal standard, the content of which must be established only by judicial practice. However, with a few exceptions, corporate social responsibility is not regulated as the responsibility of directors. This also applies to Slovene regulation according to ZGD-1, which has no provisions on corporate social responsibility at all.

For commercial companies, ZGD-1 regulates the due diligence of members of management or control bodies; stipulates that in the performance of their duties they must act with the diligence of a conscientious and honest businessman, i.e. the standard of a conscientious and honest businessman. Acting with the care of a conscientious and honest businessman is comparable to the director's duty of care under the English Companies Act (CA 2006), which is only one of the many director's duties not regulated by our law.

Slovenian company law (ZGD-1) nowhere stipulates the duty of directors to act in a socially responsible manner, e.g. for the good of the community, employees, environment, just like some other legal orders. It only regulates the duty of the members of the management and control bodies to act for the good of the company, which is different from comparative law.

Contrary to ZGD-1 the English Companies Act (CA 2006) e.g. in addition to acting for the good of the company and shareholders, it also requires consideration of the interests of employees, suppliers, customers, the community and the environment (Sec 172/1); the Austrian law on shares also stipulates that the board is obliged to run the company in the interest of the company, taking into account the interests of the shareholders, employees and the interests of the public.

2 Duties of directors according to ZGD-1 and ZFPPPP

ZGD-12, in contrast to other corporate legal regulations (e.g. UK Companies Act 2006, hereinafter: CA 2006, namely in chapter 2 General duties of directors (chapter 2 General duties of directors, Sec 171-181) does not systematically regulate general duties of directors. The law mentions them in individual chapters (on tort liability, competition, etc.) Directors' duties related to solvency are regulated by the ZFPPPP.

The legal regulation of directors' duties is completely incomparable in scope and systematicity, and thus in importance. The special feature of ZGD-1 or in general, the Slovenian regulation, which is not the best, is that Slovenian law simply leaves a large part of these rules to the non-binding rules of the code, which, however, only applies to companies listed on the stock exchange. In particular, this applies to the rules on conflicts of interest, which are almost entirely (with the exception of the rules on competitive activity) only ethical and non-binding.

The rest of the rules on directors' duties in ZGD-1 are scattered in different chapters of the law and are not comprehensive and complete enough when analysed in comparative law. For example, Article 263 of the ZGD-1, which regulates the due diligence of members of management or supervisory bodies, stipulates that they must act with the due diligence of a conscientious and honest businessman when performing their duties. More than that, ZGD-1 does not define this director's duty; the law considers it as a standard (of a conscientious and honest businessman) that must be formed by judicial practice, which is clearly a difficult task.
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Slovenian legislation defines the sole director's duty to ensure solvency according to the ZFPPIPP. This law stipulates that the management must ensure that the company operates in accordance with the ZPPIPP and the rules of the business and financial profession. When managing the company's affairs, the management must act with the professional care of the business and financial profession and, in doing so, strive to ensure that the company is always solvent in the short and long term.

The duties of the directors of a joint-stock company according to the Slovenian legal system, even though they are not systematically regulated by ZGD-1, could still be classified as follows: the duty of independent management of affairs for the good of the company (whereby the good of the company does not include the good of the stakeholders) and the duty of representing the company, the duty of careful conduct according to the standard of a conscientious and honest businessman, the duty to protect business secrets, the duty to respect the general prohibition of competition and the conditional prohibition of gainful activity, and the duty to ensure liquidity and solvency. Among these duties, it seems there is no duty of socially responsible conduct.

3 Directors are liable to the company and shareholders; what about director's accountability to stakeholders?

The relationship between the corporation and its managers (agency, agent-principal, relationship) is based on the trust of the shareholders (investors) that their invested capital will be protected from abuse or illegal appropriation by the company's management. The same applies to board members or majority shareholders, who are also in a position to abuse their position and take advantage of their relationship with shareholders.

Here, the fundamental question is to whom (shareholders, employees, creditors...) the legislation gives the right to assert compensation claims against members of management and control bodies. And last but not least, to whom the legislation gives (shareholders and employees) the possibility of judicial review of the company's operations. Legislation usually provides legal grounds for compensation claims against members of management and control bodies, which are filed on behalf of the company by shareholders and, under special conditions, also by creditors. However, according to corporate legislation in the EU and USA, employees or other stakeholders do not have the right to claim compensation against members of the management and control bodies. It is difficult to justify why this is so, since it is the employees who suffer the most from the consequences of the directors' harmful decisions.

Of course, investors also lose, but it is usually the employees, not the buyers of the company's shares, who find themselves in dire straits when directors make harmful decisions. In short, there is no serious reason why the legislation should not recognise the right to assert employee compensation claims against members of management and supervisory bodies, just as shareholders and creditors now have. In any case, it is true that the law should establish a balance between the possibilities of investors, employees and creditors to demand the elimination of violations of their rights or to insure themselves against damage.

However, corporate legislation (including Slovenian legislation) only recognises shareholders in relation to members of the management and control bodies, but nor employees neither other stakeholders, have active legitimacy to file a lawsuit. Employees and other stakeholders do not have a claim for compensation either against the shareholders or the company or to the members of the management and control bodies. Despite the fact that the employees themselves are in a position where the harmful actions of the members of the management and control bodies adversely affect their long-term social position.
4 Directors' duty to act in the best interest of the company

The fundamental question of directors' responsibility is what it means to act in the best interest of the company. Related to this is the explanation of the social responsibility of directors. The prevailing narrower interpretation is that acting for the benefit of the company means achieving the highest possible returns on invested capital and thus in the best interest of shareholders; according to this interpretation, directors have no social responsibility but only responsibility towards capital and shareholders; according to Friedman's principle: the business of business.

However, such an explanation no longer fits the modern corporation, where various stakes and interests, usually called stakeholders, are intertwined. In the world, at the current level of technological development, the inputs and thus also the interests of highly qualified work and an orderly co-natural environment, sustainable development in the community, and the coherence of interests in the entire business chain are of much greater importance to the corporation. Therefore, the concept of the benefit of the company must be interpreted more broadly, precisely by taking into account the stakes and interests of the stakeholders. These are the employees of the corporation and its business chain, the local and wider community, and business and financial partners. Acting in the interest of the company is therefore acting in the interest of all the above-mentioned stakeholders and not only the capital investors. Therefore, the social responsibility of directors also extends to them and not only to shareholders and creditors.

From a narrower understanding of what it means to act for the good of the company, the view that directors are not liable for compensation or otherwise for acting contrary to corporate social responsibility, saying that this is only a legal principle and not a sanctioned legal norm. It follows from this that corporate social responsibility is not the legal responsibility of directors of corporations unless it concerns areas that are specifically regulated by law. This, for example, applies to the applicable legislation in the field of labour rights, environment, equal opportunities, health and safety, etc.

5 Acting for the benefit of the company and responsibility to stakeholders comparatively

In some countries, the legislation explicitly states director duties (e.g. UK Companies Act), in others they are satisfied with the general norm that management is obliged to act for the good of the company (e.g. German and Slovenian) and its shareholders (in their best interest). There are very few laws (e.g. UK, Austrian, also Indian) which stipulate that it is the duty of directors to follow the interests of other stakeholders and the social community in general. It follows from this that some countries nevertheless perceive the aspect of stakeholder contributions and interests as a possible legal basis for a compensation claim against directors.

Similarly, the OECD Principles coyly state that, in addition to the duty to act in the best interests of company and shareholders, directors are expected to consider and treat fairly the interests of other stakeholders, i.e. employees, creditors, customers, suppliers and local communities. In this context, it is also important to take into account environmental and social standards. However, even according to the OECD principles, the members of the management bodies are also responsible for achieving an adequate return for shareholders. However, there is no direct legal basis, neither in the OECD principles nor in the rules of national legislation, for the responsibility of directors to employees or other stakeholders. This is clearly and unequivocally evident from the legal provisions on directors' liability for damages in national corporate laws, including the Slovenian ZGD-1.
The difference in legal binding is obvious; acting for the benefit of the company and shareholders is the legal duty of the directors, which is also sanctioned by liability for damages, as well as the sanction of recall, while for other stakeholders (including employees) it is only about expectations, which may remain unfulfilled, but nothing happens.

Duty of care and duty of loyalty in relation to stakeholders?

The duty of care and the duty of loyalty are components of the duty of trust (fiduciary duty) of the members of the management and control bodies. The duty of care imposes on the board members to perform their work well-informed, in good faith and with all necessary diligence and care, just as a prudent person would act in similar circumstances (also the care of a good businessman). Directors are forgiven for making erroneous business decisions, if they were made within the scope of the duty of careful judgment or due diligence, but it is not forgiven, if the damaging decision is made with extreme negligence, as this is not within the scope of due diligence.

The duty of loyalty means avoiding actions that conflict with the benefits and interests of the company, as well as equal treatment of shareholders (especially minority shareholders in affiliated companies).

Directors have a duty of care and a duty of loyalty exclusively in relation to the company and shareholders, in whose best interest they must act, and in no way in relation to employees. Directors have no duty of care or duty of loyalty towards employees or other stakeholders. Directors have a duty to treat all shareholders equally, even though they are actually only elected by the majority shareholders. On the other hand, there is no equal treatment of shareholders and employees, although, for example, the employees, through their representatives in the supervisory board together with the members of the supervisory board who are the representatives of the shareholders, actually appoint.

6 Compensation liability of directors in the Republic of Slovenia

The amended Article 263 of the ZGD-1 I (Official Gazette of the RS, No. 55/2015, dated 24 July 2015) regulates the due diligence and responsibility of directors (members of the management or supervisory body). It stipulates, just as until now, that the director must act for the good of the company with the care of a conscientious and honest businessman and protect the company's business secrets (duty of care and honesty).

The directors are jointly and severally liable to the company for the damage caused as a result of the violation of their tasks, and these tasks are not defined in the law or by examples; only the general duty of management for the good of society applies. However, within the framework of the rule on the reversed burden of proof, directors have the opportunity to prove that they performed their duties honestly and conscientiously.

The rule also applies that the director does not have to compensate for the damage, if the action by which the damage was caused to the company is based on a legal resolution of the general meeting; shareholders can therefore decide that for the damage caused by the directors, e.g. to employees or the community (e.g. environmental damage), they are not responsible, by adopting the appropriate resolution at the general meeting.

The director's liability for damages is not excluded, even if the supervisory board or the board of directors approve the act. The company may waive compensation claims or set them off only three years after the claim has arisen if the general meeting agrees to this and if this is not
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objected to by a minority holding at least a tenth of the share capital in a statement entered into the minutes of the general meeting.

The **disciplinary responsibility** of workers as an institute is **incompatible with the status-legal position of the management person** who runs the company; so the law governing labour relations. In Slovenian economic practice, this provision is widely used, so we can say that in practice, the director of a company is not liable for disciplinary action.

The duty of care and fair dealing is prescribed only for the good of the company and not for the good of the stakeholders; directors also have no duty to act socially responsible. It follows from this that **for socially irresponsible behaviour** or acting against the rules of corporate social responsibility, according to Slovene law, the **director is not liable for damages, nor is this a valid reason for recalling the director.** This is unacceptable from the point of view of the constitutional provisions on Slovenia as a welfare state, and especially from the point of view of the implementation of international acts regulating corporate social responsibility.

7 Social responsibility of directors in comparative law

There are significant differences in the EU countries regarding the stipulation of directors' responsibilities regarding corporate social responsibility in the corporate legislation. Otherwise, **no national legislation explicitly states that corporate social responsibility is the responsibility of the directors.** However, some corporate laws extend the responsibility of directors to consider the interests of the company's stakeholders and corporate social responsibility (Austria, UK, China, India).

The **Austrian Companies Act** (Aktiengesetz Article 70.) stipulates the responsibility of the board to conduct business not only in the interest of the company but also **taking into account the interests of shareholders and employees, as well as the interests of the public.**

The **German Stock Corporation Act** (Aktiengesetz, Article 93 AG) imposes duty, diligence and honesty on board members (directors). However, directors are not considered to be in breach of this duty, if they have reasonable grounds to believe that they have acted on the basis of relevant information for the benefit of the company (rule of business judgment). The directors must prioritise the interests of the company and its shareholders, as they are otherwise liable for all damages incurred. On the other hand, **acting contrary to the principles of corporate social responsibility is not considered a violation of the director's duty,** and therefore directors are not liable for damages for such actions.

The **UK Companies Act** 2006 (Companies Act, Section 172, CA) **mentions CSR among the duties of a director.** It stipulates that, in addition to the interests of the company and shareholders, the company director must also take into account the interests of the company's employees and the need to strengthen the company's business relations with suppliers, customers and others. The director's duty is then to take into account the impact of the company's operations on the **community and the environment**, to maintain high standards of business conduct and, ultimately, to treat the various members of the company fairly (CA, Sec. 172). The director's duty **to consider the impact of the company's operations on the community and the environment** is a step forward towards compliance with corporate social responsibility, but it is far from being the responsibility of the directors.

Corporate social responsibility is also **not explicitly mandated as a director's duty under US federal law.** However, directors in the United States are required to fulfill their fiduciary duties, which include acting in the best interests of the company and its shareholders. Traditionally, the fiduciary duty of directors in the US has been interpreted to mean **maximising shareholder**
value. However, there has been a shift in recent years with increasing recognition that directors can consider broader stakeholder interests, including social and environmental factors when making business decisions.

Corporate social responsibility is not explicitly mandated as a director's duty under Chinese law. However, the concept of CSR has gained increasing attention in China, and there are regulations and guidelines that encourage companies to engage in socially responsible practices. The Company Law of the People's Republic of China, which governs companies in China, focuses primarily on the duties and responsibilities of directors towards the company and its shareholders. The law does not specifically require directors to prioritise CSR activities. However, the Chinese government has been actively promoting CSR through various means. The Guidelines on the Promotion of CSR, issued by the Ministry of Industry and Information Technology in 2008, provide recommendations for companies to engage in CSR practices. The guidelines encourage companies to consider environmental protection, consumer rights, employee welfare, and social welfare, among other aspects.

Under Section 135 of the India Companies Act, 2013, companies meeting specified criteria are mandated to spend at least 2% of their average net profits of the preceding three financial years on CSR activities. These companies are required to establish a CSR committee consisting of their board of directors, which is responsible for formulating and monitoring CSR policies and activities. While the Act does not explicitly make CSR a director's duty, the board of directors, as part of their fiduciary responsibilities, is expected to oversee and ensure compliance with the CSR provisions. Directors play a crucial role in setting the strategic direction, approving CSR policies, and monitoring the effective implementation of CSR initiatives.

8 Conclusions

The weakness of the regulation of corporate social responsibility in corporate legislation calls for decisive steps in this direction. The described solutions of some countries, however, encourage us that the upgrade of corporate law is the way to implement corporate social responsibility.

Therefore, in the future, it would be more than necessary to examine what binding rules of corporate legislation make sense for the implementation of corporate social responsibility; above all, the legal definition of corporate social responsibility and the duties and responsibilities of directors regarding it.

It is also necessary to examine how the definition of corporate social responsibility (EU Commission 2011), as the responsibility of companies for the impact on the environment and society, should be transformed into an EU directive that would be implemented in national legislation with a new definition of duties and responsibilities of directors, including the duty of directors to integrate social, environmental, ethical, human rights, and consumer concerns into their operations and core strategy in close cooperation with their stakeholders.

The EU directive defined the duty of companies to introduce an evaluation of the impact of their activities on the environment and society (identification and measurement of the impact of companies on issues in the fields of society, environment, human rights, economy, etc.) as a binding element of annual reporting, and also the duty of public disclosure once a year. However, the directive should make it the duty of corporations to include (integrate) social and environmental goals (corporate social responsibility) in their corporate strategies and corporate
governance codes and, consequently, in their operations, as a corporate duty of directors, for the violation of which they are liable for damages.

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