

## PERMUTATIONS IN CORPORATE - SOCIAL RESPONSIBILITY

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### 1. Abstract

*In this article, we address three aspects, which are subject to correlation between corporations and social responsibility mechanisms. We have targeted three mechanisms, which we have found to have gone through permutations in the Israeli corporate laws - (1) Regulations; (2) Good Publicity; and (3) Donations.*

*We provide a glance to the important shift in the perspectives of both legislators and courts towards combining social responsibility mechanisms in companies, and also, in defining the purpose of a limited company in light of social responsibility principles. Nevertheless, we show that some countries use compelling provisions, while other do not.*

*We further discuss methods used by companies to create empathy among its investors, stake holders and customers, by adopting and publishing moral codes. In addition, we present a moral problem in allowing companies to donate funds to social causes, especially while they are in a poor financial condition.*

### 2. Introduction; Preamble

Over the past few years, the Israeli market has witnessed an increasing number of investors and companies, expressing explicit social and environmental concern. Many companies have adopted a set of "social investment policies", showed willingness to employ employees from weakened population groups, and took actions to enhance social responsibility mechanisms within the

companies themselves, whether as a marketing element or as a result of a new corporate and business perception.

In this article we shall address the strengthening of the aforementioned phenomenon in the corporate world, through a number of direct and indirect perspectives, all contributing to the creation of a solid foundation of social responsibility mechanisms. That said, we have targeted the Israeli corporate field, due to the fact that a legal analysis must focus on a relevant set of rules, and due to the many permutations in the Israeli Companies Law during the past few years. And so, during the past 5 years, the Israeli Companies Law of 1999 (herein after: the "**Israeli Companies Law**") has been amended 14 times. Some of the amendments are considered extremely comprehensive.

### 3. Regulation

Public companies in Israel have been subject to an extraordinary number of legal amendments regarding all sorts of actions to be implemented within the company. Some of which are in the form of advised provisions ("Comply or Explain") and some are mandatory.

3.1 Before discussing these mechanisms, it seems necessary to first understand what "Corporate Governance" is and how it relates to the concept of social responsibility. While a single and clear definition of "Corporate Governance" is lacking, it is mostly referred as the linkage and reciprocity between different organs in the corporation<sup>1</sup>. The broad variety of organs found in corporations and the variety of corporations themselves, compels a wide reference to "Corporate Governance". We would therefore focus on *some* aspects which relate to the concept of social responsibility in corporations.

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1. **ETHAN WOLF-HOLTZ**, COMPANIES - A GUIDE FOR THE MANAGER, THE DIRECTOR AND THE SHAREHOLDER (2014).

In referring to the legal amendments made in the Israeli Companies Law, which is a rather new law that came into force only in 2000, perhaps the most comprehensive amendment is the 16th amendment<sup>2</sup>, at the header of "Optimizing the Corporate Governance". This amendment *de facto* introduced the Israeli commercial and legal systems with the already developed mechanism of "Comply or Explain".

The mechanism of "Comply or Explain" (herein after: "CoE") seeks to replace the previous approach of setting binding laws and regulations. Instead, those who hold the CoE approach usually set codes, which listed companies may either comply with, or, if they do not comply, explain to the public the reasons for the failure to comply. Such mechanisms were also implemented in the UK Corporate Governance Code of 2012<sup>3</sup>.

According to the aforementioned, the purpose of the CoE mechanism is to allow the market itself to decide, whether to invest in a certain company, do business with it, or purchase its products or services. Companies may indeed deviate from the uniform standard of legal provisions, however they are still subject to extensive disclosure provisions. The disclosure, which may lead to the realization of the risk that investors will sell their shares and clients will avoid purchasing. Hence, this facilitates a process for "market sanctions" (rather than legal sanctions).

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2. The 16th amendment to Israeli Companies Law of 1999, at the header: "Optimizing the Corporate Governance".

3. The UK Corporate Governance Code of 2012 (2012). Retrieved May 2, 2014 from <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf>.

See also - The German Corporate Governance Code of 2013 (Deutscher Corporate Governance Codex), of (2013). Retrieved May 2, 2014 from [http://www.corporate-governance-code.de/eng/download/kodex\\_2013/D\\_CorGov\\_final\\_May\\_2013.pdf](http://www.corporate-governance-code.de/eng/download/kodex_2013/D_CorGov_final_May_2013.pdf).

The very concept of CoE was first introduced by the Cadbury report of December 1992 - a committee established in May 1991 by the Financial Reporting Council at the London Stock Exchange to investigate financial aspects of corporate governance<sup>4</sup>.

The reference of the CoE provisions in the Israeli Law to the social responsibility principles is mostly indirect and is achieved by assuring a more independent composition of the board of directors and the organs, therefore allowing more independent opinions to be heard in the ongoing management of the company.

Nevertheless, one of the aforementioned clauses suggests the adoption of a more direct provision of social responsibility, by determining that in the process of appointing directors in private companies, one should take into consideration the applicant's gender, in addition to the applicant's knowledge, experience and the company's special needs<sup>5</sup>. This provision seeks to supplement the already existing (and mandatory) provision in the Companies Law<sup>6</sup>, stating that upon appointing outside directors in a public company, in which all of the other directors are from one gender, the appointed outside director would be from the opposite gender.

- 3.2 While the legal provisions regarding gender equality in the private sector are formatting idly, the regulator's provisions in this aspect in the public sector are far more prominent. Accordingly, we wish to indicate that the Israeli Governmental Companies Law of 1975 (herein after: the "**Governmental Companies Law**") includes an elaborated provision, according to which, in the appointment of all board members, the

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4. The Cadbury report of December 1992. Revrieved March 4, 2014 from <http://www.ecgi.org/codes/documents/cadbury.pdf>.

5. The Israeli Companies Law, 2nd addendum, section 2.

6. Ibid, Section 239(d).

appointing agents must ensure an appropriate representation to both genders<sup>7</sup>.

This provision concerning the public sector is significant for a number of reasons:

- (a) The provision is mandatory and not voluntary;
- (b) The wording imposes de facto an obligation to consider the gender of any director appointed;
- (c) The wording of the aforementioned clause refers to a consequential form of equality, rather than providing equal opportunities (which are also much harder to enforce).
- (d) The obligatory nature of the provision compels the courts to address the matter in a rather strict manner, as we would present in the following paragraph.

3.3 Upon examining the Israeli ruling of the Israeli courts regarding the aforementioned provision, it can be seen clearly that the Israeli courts are leaned toward a strict commentary of the clause, and therefore assist substantially in its enforcement.

3.3.1 In the matter of the **Women's Network**<sup>8</sup>, the Israeli supreme justice Matza interpreted the clause by imposing an active duty on the Israeli government to appoint women to governmental companies' boards:

**"I am hastened to say that this is not a new legal underpinning of rights as the fundamental right to equality between genders..., but a new norm, which aims to positively provide proper representation of both genders in the composition of the boards of directors in**

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7 . The Israeli Governmental Companies Law of 1975, section 18A.

8. HC 453/04, **Women's Network v. the Israeli Government** J 48(5) 501, 414-515 (1994).

**governmental companies and in its managing entities...".**

And so he added:

**"Section 18A, which presents the purpose of the law over time, does not reduce to the declaration of the existence of the aforesaid purpose...but outlines a practical task to be implemented in an immediate manner... it is not enough to provide equal opportunities to all... imposing merely formal equality raises the concern that the customs of people would commemorate discrimination. Repairing past injustices and achieving practical equality can, therefore, be only achieved by preferential treatment of weakened groups".**

3.3.2 The Israeli Supreme court has extended this approach in the matter of **Yael Aran**<sup>9</sup>, where supreme justice Levi determined that the mentioned provision is not to be examined in regards to the group of those who hold senior positions in the specific company, rather in a more "transverse" view, concerning all senior positions on governmental entities. And so he stated:

**"It is required to perform a vertical cut (in order to examine the rates of representation of both genders on all ranks inside the office or the unit) and also a horizontal cut (in order to examine the rate of women officiating in a certain rank in all units and offices)".**

3.4 The matter of equality in Israeli governmental companies is also expressed in regulations focused on integration of

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9. HC 5755/08, **Yael Aran v. the Prime Minister** (published on: 20.4.2009).

minorities in senior positions. In accordance to the aforesaid, the Israeli Governmental Companies Law<sup>10</sup> states as follows:

**"(a) in the composition of a governmental company, there should be an appropriate representation of the Arab population".**

3.5 In the matter of **The Association for Human Rights in Israel**,<sup>11</sup> the Israeli supreme court discussed the matter of appointing Arabs to positions in the Israeli Land Administration (which is a private company and not a governmental one), yet supreme justice Zamir emphasized that due to the ongoing rivalry between the Jewish and Arab populations in Israel, the need in strict standards regarding the matters of equality, only grows.

3.6 Both regulatory amendments and the interpretation of the courts have been materially affected by the new approach of enhancing social responsibility mechanisms in corporations. A salient example to this new approach may be perceived through the wording and commentary to section 11 of the Israeli Companies Act of 1999. While the Companies Ordinance, which preceded the Companies Law, yearned after the British law and after the approach that the purpose of companies is only to maximize the profits of the shareholders, the new Companies Law clearly states that the company may also take under consideration the interests of the general public, employees, creditors and so on, as a part of its complex of interests.

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10. Israeli Governmental Companies Law (footnote 7 herein above), section 18A1, as amended in the 11th amendment of the year 2000.

11. HC 6924/98, **The Association for Human Rights in Israel v. the Israeli Government** J 55(5) 15, (2001).

The Hellenic Corporate Governance Code for Listed Companies, August 2013 (Greece, 2013)<sup>12</sup> uses a more suggestive wording, and states as following:

**"In discharging its role, the board should take into account the interests of key stakeholders such as employees, clients, creditors, and the communities in which the company operates"**<sup>13</sup>.

Despite the "permitting" nature of the wording, the Israeli supreme court<sup>14</sup> has already expressed the shift toward the new approach of social responsibility, and stated (even before the legislation of the Companies Law):

**"It seems that in developing modern trends both the companies and their managers should not only take into consideration the benefits to the shareholders, but also the benefits to the companies' employees, and the benefits to the general public".**

3.7 Although the UK Companies Act of 2006 does not clearly addresses the concept of the company's "purpose", it does states the considerations in which directors are bound to follow. These considerations are greatly affected by the approach of combining social responsibility mechanisms in companies, as shown below<sup>15</sup>:

**"A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to... (b) the interests of the**

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- 12. evrieved May 2, 2014 from:  
[http://www.ecgi.org/codes/documents/hellenic\\_cg\\_code\\_oct2013\\_en.pdf](http://www.ecgi.org/codes/documents/hellenic_cg_code_oct2013_en.pdf)
  - 13. id, p. 7.
  - 14. FD 7/81 **Fnidar v. Castro**, J 37(4) 673, 695 (1983).
  - 15. The UK Companies Act of 2006, section 172.



**company's employees; (c) the need to foster the company's business relationships with suppliers, customers and others; (d) the impact of the company's operations on the community and the environment...".**

Canada, as a contrary example, does not impose a mandatory requirement; The Canada Business Corporations Act<sup>16</sup> sets that the duties of directors and officers of corporations are owed to the corporation. However in the BCE Inc.<sup>17</sup>, the court found that although directors must consider the best interests of the corporation, it may also be appropriate to consider the impact of corporate decisions on shareholders.

#### 4. Good Publicity

It is a well known fact that companies wish to create good publicity, not only in order to attract customers to purchase goods or services, but also in order to attract investors.

4.1 How would companies attract investors? The answer was not always uniform. While in the past, the majority of investors were private entities, it is a well accepted notion today that the strongest investors in Israel nowadays are institutional investors (herein after: "**institutionals**").

The new reality imposes great pressures on the insitutionals to choose carefully where they invest the public's money they manage.

4.2 From the regulator's point of view, there are two methods to address this situation;

4.2.1 Setting CoE codes, as mentioned herein above, in the hopes that the market itself would response cleverly to companies' disclosures;

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16. The Canada Business Corporations Act of 1985, section 122(1).

17 . BCE Inc. v. 1976 Debenture holders 3 S.C.R. 560 [2008].

#### 4.2.2 Imposing binding provisions on institutionals in regards to proper investment procedures.

During the past few years, the Israeli regulator has occasionally intervened in the institutionals' investment procedures and has set a number of provisions compelling institutionals to act in a more responsible a meticulous manner in their investments.

One of the known examples to the aforementioned is the adoption of the recommendations of the Hodak Committee<sup>18</sup>, which intervenes in the decision making processes of the institutionals while investing funds in non governmental bonds. This Committee determined the parameters for the purchasing of credit through the purchase of non governmental bonds, by institutionals, and presented its recommendations on February 2010. The recommendations were presented to the Commissioner of the Capital Market in Israel and were later adopted by him as mandatory provisions.

Such intervention would have been a great opportunity for the regulator to force the institutionals to set social responsibility mechanisms within the promissory notes, so that the borrowing or invested-in company would have to follow such mechanisms through out the period of loan repayment. If our voices are heard, we recommend doing so - meaning, we recommend setting compelling provisions on institutionals according to which they would be able to invest only in companies which undertook to promote social responsibility principals.

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18. The Committee to determining the parameters for the purchasing of credit through the purchase of non governmental bonds, by institutionals, February 2010 (the "Hodak Committee").

- 4.3 From the Companies' perspective, they may adopt "moral codes" or "codes of business conduct" which are targeted to attract both investors and customers.

Adopting moral codes allows the viewer to relate with the company and support it, for the sense of empathy towards the contents of the code. Therefore, we perceive moral codes as an effective method of publicity.

The aforementioned codes reflect principles according to which the company wishes to follow. But those principles are not perceived as complying, and therefore, we would highly recommend that companies which publish such codes, appoint an appropriate supervisor that will ensure the enforcement and suitability between the content of the code to the conduct of the company.

## 5. Donations

- 5.1 Companies are allowed to donate funds to social and environmental causes, even if the companies' objects are not related to the relevant causes, providing that the companies' articles of association permit such donations<sup>19</sup>. The matter of donations is not trivial at all, and it is even more complex when it concerns public companies.
- 5.2 We shall present this matter as follows: Any shareholder is entitled to donate as many funds as he pleases in a private manner, out of his personal pocket. Donations on behalf of limited companies are somehow different, for once a donation is granted by the company, all shareholders and creditors may be affected from this decision. Such donations may therefore result in claims of discrimination against minority shareholders

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<sup>19</sup> The Israeli Companies Law, Section 11.

if the donation was made to the request (or under the influence) of the controlling shareholder.

- 5.3 The moral problem becomes even more complex in companies which raise funds (in example by issuing bonds) due to their inability to accomplish business processes. In this situation, companies are allegedly still permitted to donate funds, however such donation may conflict with the creditors' (in our example - bond holders) position in the company, and may also affect the company's solvency. On the other hand, if a company proves its solvency by distributing dividends, and only afterwards do certain shareholders donate from their own funds, such donations are less likely to harm the standing of the creditors and minority shareholders in the company.

## 6. Conclusion

The discussion about permutations in corporate - social responsibility allows a glance to two emerging fields, in terms of world recognition and regulations. It is no secret that some countries register more corporations rather than private citizens, and therefore the significance in addressing the role of companies (and different "players" within the corporate field) in the area of social responsibility.

In this article, we addressed three perspectives, which create correlation between corporations and social responsibility mechanisms - regulations, good publicity and donations.

We have showed the important shift in the perspectives of both legislators and courts toward combining social responsibility mechanisms in companies, and even in defining their purposes in light of social responsibility principles. Nevertheless, some countries still use more compelling or suggestive wordings within the law, while others only mention the possibility of doing so.

We have also recommended that the regulator would use its power to obligate institutionals to set compelling provisions within promissory bonds upon investing their funds and as a condition to performing such investments.

We have further discussed companies' methods of creating empathy among its investors and customers, by adopting and publishing moral codes. Still, we suggest that such companies would show its commitment to the content of the codes by appointing a supervisor within the company to ensure the implementation of the ethical principles published.

Despite the aim to enhance social responsibility principles, we urge companies to carefully examine actions of contributions, among others, according to the companies' financial condition.

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