

## *Discussion Draft*

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This portion of the White Paper will focus on corporate environmental stewardship. It will provide a working definition of corporate environmental stewardship and identify the drivers that motivate it. It will then suggest legal and regulatory strategies that might be used to further promote and facilitate this voluntary, environmentally-beneficial corporate behavior.

### **1. Defining “Corporate Environmental Stewardship”**

Corporate environmental stewardship refers to environmentally-beneficial actions that go beyond what is legally mandated. These practices are self-motivated, in the sense that they are not caused by regulatory requirements. Corporate actions that respond to regulatory requirements qualify as compliance, not stewardship. Some have said that environmental stewardship consists of actions that go “beyond compliance.”

Why would a company want to reduce its environmental impacts to a greater extent than the law requires? Another way of asking this is: what are the drivers behind the recent corporate environmental stewardship movement? A partial list of these motivating forces would include the following:

- Investor preferences. Increasingly, publicly-held corporations are facing investor pressure to improve their environmental performance. This may be because investors value the environment and prefer companies that share their values. It may also be because some investors view environmental performance as an indicator of good corporate management.
- Customer preferences. Some customers prefer environmentally-friendly products (e.g. dolphin-friendly tuna). In these markets, success can depend on demonstrating that the company is acting to protect the environment.

- Competitive advantage and the pursuit of profit. Some have argued that pollution results from resource inefficiency, and that more complete use of resources would both save money and decrease pollution. Where this is true, pursuit of environmental goals can enhance the bottom line. Improved environmental behavior can also improve the bottom line by reducing regulatory costs. Companies that engage in pollution prevention can place themselves beyond the reach of regulation and so reduce their compliance costs.
- Corporate brand. Some companies may seek to project themselves as more environmentally advanced than their competitors and make this part of their corporate brand. Ford is currently attempting to do this as a way of defining itself against the other Big Three automakers. Toyota's promotion of its hybrid vehicles is another contemporary example.
- Corporate goodwill. Even where companies do not make environmental values part of their brand, they may still see their reputation for environmental responsibility as important to their corporate goodwill. There are numerous examples of environmental violations causing a drop in corporate goodwill and so in share price.
- Employee morale and retention. Some studies show that companies that make a significant and visible commitment to environmental protection experience improved employee morale and retention, perhaps because employees feel better about the company. Employee turn-over is a significant expense, and so improved retention can impact the bottom line.
- Threat of future regulation. Industries that are faced with the threat of future regulation may decide to pro-actively improve their environmental performance so as to reduce the likelihood of such regulation being passed into law.
- Insurance costs. Insurance companies, in setting their rates, are beginning to look more closely at the risk of environmental liabilities and compliance costs. Companies may attempt to improve their environmental performance in order to qualify for lower rates.
- License to operate. Corporations are legal entities whose existence must be approved by the state in which they are domiciled. Historically, this licensing function has considered whether the corporation serves the public interest. It is conceivable that corporations with abysmal environmental performance could lose their license to operate.

For these and other reasons, private companies may decide to improve their environmental performance beyond the levels required by law. Corporate environmental stewardship is the response to these drivers.

## 2. Corporate Environmental Stewardship and the Evolution of Legal Systems

The law cannot require corporate environmental stewardship since this behavior, by definition, consists of activities that go beyond what the law requires. Yet legal mechanisms may promote and facilitate stewardship. What regulatory strategies would most effectively encourage the expansion of corporate environmental stewardship?

Gunther Teubner's writings on the evolution of legal systems provide some useful insights into this question.<sup>1</sup> Teubner argues that all legal systems progress through three stages: formal law, substantive law and reflexive law. In formal law systems, individuals interact within a framework of legal rules. For example, property, contract and tort law provide a system of formal law rules within which individuals engage in market transactions. Nuisance and trespass law provide a set of formal rules to govern environmental impacts of one property owner on another. As society becomes more complex, formal law systems are no longer able to meet social needs. This leads to the next stage in the evolution, substantive law, which consists of specific, substantive requirements designed to meet social goals. For example, the Uniform Commercial Code (U.C.C.) comes to supplement or replace common law notions of contract. Environmental statutes prescribing specific pollution control requirements come to supplement or replace common law nuisance principles as a way of achieving environmental goals.

The ever-increasing complexity of society eventually overwhelms even substantive law. Specific legal requirements proliferate, generating a legal system that is overly complicated, rigid and cumbersome.<sup>2</sup> In such a situation, government officials can no longer effectively prescribe behavior for all the entities that have an impact on social goals such as environmental protection. The only way to achieve these goals is for the organizations and companies, who know their own operations far better than the government officials do, to take on the task themselves. This requires a major paradigm shift. Instead of government requiring private actors to conform to societal goals, the private entities must

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<sup>1</sup>See Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 *Law and Society Review* 239 (1983).

<sup>2</sup>Some would argue that this describes the current state of environmental regulation.

internalize and adopt these goals as their own. Having done so, they must then reflect on and manage their own actions so as to better promote these goals. Reflexive law, the final stage in the evolutionary scheme, is law that promotes this type of self-governance. It does not impose specific requirements. Instead, it seeks to facilitate and create incentives for companies and organizations to internalize societal goals and improve their self-management in pursuit of them.

This would appear to be just the type of law that is needed to expand corporate stewardship. As defined above, corporate stewardship consists of self-initiated improvement in environmental performance. Reflexive law is law that seeks to promote and facilitate self-management with respect to social goals. Those interested in enhancing corporate stewardship would do well to look to reflexive law strategies.

### **3. Reflexive Law Strategies for Expanding Corporate Environmental Stewardship**

Reflexive law seeks to encourage private actors to do two things. It seeks to get them to internalize societal goals. It then attempts to get them to actively manage their own operations so as to better support these goals. Following the reflexive law method, government strategies to promote corporate environmental stewardship should consist of policies that: (1) encourage corporations to internalize the goal of environmental protection; and (2) promote the internal management practices that are essential to achieving these goals.

Government could encourage more companies to internalize environmental goals through policies that:

- Inform investors about corporate environmental performance and liability risks. This could increase investor pressure on companies to adopt environmental goals. Securities and Exchange Commission (SEC) disclosure requirements figure importantly here. In addition, EPA could define sustainability criteria for companies and either require disclosure related to these criteria, or do its own ranking of firms based on these criteria.
- Inform consumers about the environmental qualities of products. This could increase market pressure to produce environmentally-friendly goods. Current examples would include the federal Energy Star program which provides information on the energy efficiency of certain consumer goods. This and other such approaches could be expanded.

- Educate the general public. The more that stakeholders understand about the environmental implications of business activity, the better positioned they will be to use their market, shareholder or political power to increase corporate focus on these issues. Government could play a role in educating the public about the environmental implications of business activity.
- Demonstrate the opportunities for green profits. The EPA could collect and share information about companies that have enhanced their bottom line through pollution prevention and increased resource efficiency. This would motivate other companies to try and do the same. The government could also provide technical assistance in this area. The EPA's Design for the Environment initiative, in which the agency worked with industry sectors to identify pollution prevention measures that would save the companies money, approximated this approach.
- Publicly recognize those who have successfully internalized environmental goals. Public recognition of corporate environmental leaders would encourage them to maintain their commitments and would provide an incentive for others to emulate them. The federal Performance Track program, and related state programs, provide a useful example and could be expanded and replicated.
- Rank companies according to environmental criteria, and publicize the rankings. For example, the Toxics Release Inventory (TRI) publicly ranks major companies according to the amount of toxic pollutants that they have released that year. No company wants to be at the top of this list. The TRI thus provides companies with an incentive to improve their environmental performance. This approach could be expanded to other areas. For example, EPA could issue a Greenhouse Gas Release Inventory that would provide incentive for companies to voluntarily reduce their GHG emissions.
- Challenge an industry to improve its environmental performance. Publicly challenging an industry to meet an environmental goal is one way of encouraging internalization of that objective. This has been done in EPA's 33/50 program in which the chemical industry faced, and met, goals with respect to toxic substances, and in EPA's Green Lights program which seeks to enhance energy efficiency. This approach could be replicated in other areas.
- Set bold and clear environmental goals for a community. An example would be the Clean Charles initiative, in which government officials set a goal of a fishable and swimmable river by the year 2005. This clearly defined and well-publicized goal motivated corporations, government agencies and citizens to take action to achieve it. This approach could be replicated with respect to other valued resources.
- Provide a credible threat of future regulation. A desire to avoid future, prescriptive regulation can motivate companies to pro-actively embrace environmental goals. It might be useful to attempt such an approach with respect to greenhouse gas emissions which are regulated in many parts of the industrialized world but not yet in the United States.
- Spell out the scope of fiduciary duties. If fiduciary duties were interpreted to include responsibility for corporate environmental performance, this might encourage boards of

directors and other company officials to internalize environmental goals. This may require activity by legislatures and courts.

Government could promote more self-reflection and improved environmental management through policies that:

- Provide technical assistance in advanced environmental management. This could include technical assistance in environmental accounting, or in the design and implementation of environmental management systems (EMS).
- Reward active environmental management. For example, a current U.S. EPA policy would reduce penalties for those facilities that discover a violation through a bona fide environmental management system and self-report it.<sup>3</sup> Agencies could also find other ways to reward such beneficial behavior.
- Require organizations to engage in environmental planning. Government agencies should consider requiring targeted industries to undertake pollution prevention planning as a condition of permit issuance. This would promote an important aspect of internal environmental management.
- Restructure environmental regulation so as to support integrated planning. Currently, environmental statutes are divided by medium (air, water, waste, etc.) Good pollution prevention planning requires attention to all media simultaneously so as to be able to see facility as a whole and to identify cross-media pollution transfers. Integrated permitting along the European model, in which a facility obtains a single permit to cover all media, would facilitate this type of integrated planning.

These reflexive law strategies should supplement formal and substantive law approaches to environmental protection, not replace them. If adopted, they could play a constructive role in promoting the internalization and active pursuit of environmental goals, and so in enhancing corporate environmental stewardship.

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<sup>3</sup>U.S. EPA, *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations*, 65 Fed. Reg. 19,618 (April 11, 2000).