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Implications of Corporate Disasters on Duties and Responsibilities of Directors' and Officers' towards other Stakeholders

Dr Kumudini Heenetigala

College of Law and Justice

Victoria University, Melbourne, Australia

Kumi.Heenetigala@vu.edu.au

Dr Chitra Sriyani De Silva Lokuwaduge

College of Business

Victoria University, Melbourne, Australia

Chitra.DeSilva@vu.edu.au

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ABSTRACT

Implications of corporate disasters as a result of corporate irresponsibility have had significant impact on the society and environment and their affects are seen after many years. This paper explores the duties and responsibilities of directors and officers on environmental disaster and their impact on society and environment using a sample of 6 case studies around the world. The finding of this study shows that shareholder primacy approach has negative impacts on the other stakeholders who are affected by the activities of the firm. Even though, corporate governance codes refer to stakeholder interest, corporations' law stresses on shareholder value. Given that the impact on the society and environment of corporate disaster which is still happening even in 2013, this study recommends that the corporations law in relation to duties responsibilities directors' and officers' should be extended to other stakeholders other than the shareholders.

Keywords: Board of Directors, Corporate Social Responsibility, Stakeholders, Ethics

INTRODUCTION

Environmental disasters in the past have brought much attention to ethical responsibilities of a corporation. High profile companies are charged for failure of their duties of care, negligence and misconduct, which had significant impact on the society and environment. The most recent case in the news was the asbestos threat as a result of mishandling by Telstra and NBN Co, which shows that it still keeps happening even in 2013. Complying with legislation and regulation have a strong influence in the way business operates, but those corporations that are socially responsible tend to operate in a manner that fulfil the wishes of society through legal and ethical behaviour.

Corporate disasters in the recent past have brought much attention to the duties and responsibilities of directors and officers. These disasters in both developed and emerging markets countries have been partly attributed to the failure of directors' duties of oversight. Businesses conduct many different activities that not only have an impact on economy but also have an impact on society and environment. In the current legal framework in Australia, Corporations Act 2001 and under the common law, directors owe a fiduciary duty to the company as well as the shareholders. However, in the case of insolvency director's duties expand to creditors and other stakeholders such as employees and pensioners (Newman, Stavis & Renick 2005). Disasters do happen but irresponsibility for the betterment of one group at the expense of the others is not an acceptable.

In the case of corporate disasters such as Exxon Valdez, James Hardie, Bhopal Gas tragedy, BP oil spill what were the duties of directors? If the duties of directors are to govern a corporation to ensure that the shareholders interest are met, failure to consider their duty to other stakeholders in above situations would have an adverse impact on shareholder value as well as corporate reputation. Additional legal obligations are imposed on companies and directors in relation employees and environment.

This paper will analyse case studies in relation to environmental disasters of five corporates around the world to understand a company's responsibilities especially in relation to duties and responsibilities of directors to other stakeholders who will be affected by the activities of the firm.

LITERATURE REVIEW

Directors' Duties and Responsibilities

In the current legal environment, directors' duties are regulated by the *Corporations Law* (2001) and courts will punish failure to meet director responsibilities. According to Section 181(1) of the *Corporations Act 2001* (Cth) directors and other corporate officers are required to exercise their power and act in good faith and in the best interests of the corporation, however it does not explain what they mean by interests of the corporations (Marshall & Ramsay 2012). In the context of UK, amendments were made to the companies act in 2006. The 'section 172(1) of the *Companies Act 2006* imposes a duty upon a director to act in the way he or she 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 (a) the likely consequences of any decision in the long term, (b) the interests of the 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, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company' (Marshall & Ramsay 2012, p. 314)

Marshall and Ramsay (2012), further argued that section 172 emphasise, directors primary responsibility is to make decisions for the benefit of its shareholders and not to the benefit of the wider group of stakeholders but permissive enough to allow directors discretion to take into account the interests of stakeholders other than the shareholders.

According to Blair and Stout (1999), a company has interests which are independent of any single set of people affected by it, including shareholders. Thus, the role of directors is to mediate a constantly shifting set of interests.

Theoretical Perspective

According to “shareholder primacy” view, a corporation is run for the sole benefit of the shareholders, therefore, directors as agents of the company has an obligation to maximize shareholder value. Accordingly, Friedman (1970) states, Corporate Social Responsibility is married with corporate profits motives to maximize shareholder value (Brueckner 2010). He argued that a firm’s responsibility is primarily towards maximizing the wealth of the shareholders (Friedman 1970; Sundaram & Inkpen 2004), whereas other schools argue that a firm has an obligation, not only to its shareholders, but to all stakeholders whose contribution is necessary for the success of the firm (Donaldson 1983; Freeman 1984).

Freeman (1984) presented the stakeholder theory and developed the model of the stakeholder governance model. His ‘stakeholder model’, defines stakeholders as: ‘Any group or individual who can affect or is affected by the achievement of the organization’s objectives’(Freeman 1984). This view recognises that not only ‘inputs’ and ‘outputs’, but also the importance of the relationships between a company and its stakeholders in achieving objectives of the organizations, hence ‘stakeholders should have input into a company’s decision-making processes for either instrumental reasons, for example in order to achieve buy-in, or for normative reasons, because the company has a moral obligation to those stakeholders to involve them in how the company is run (Jensen 2001).The emerging literature contributes to explain the theory in detail such as Donaldson and Preston (1995) outlined three distinct aspects of the theory as descriptive, which describe the specific characteristics of corporate behaviour, instrumental theory which addressed the connections or lack of connections between the stakeholder management and the corporate objectives and the normative stakeholder theory which explores the ethical philosophical and moral guidelines used to interpret the activities of the company. Donaldson and Preston (1995) mainly focus this normative or intrinsic value of the company as the core of stakeholder theory (Marshall & Ramsay 2012), which considers stakeholders as the “end” while the other two aspects are regarded as “means” or how stakeholders’ value could be used to improve the performance (Allen 2001).

Jensen (2001) states that focus on maximising economic goal is focusing on a single goal for managing an organisation, whereas firms focus on stakeholders can result in multiple goals. The current issues facing companies due to globalisation have brought much attention to serving stakeholders who may be affected by their operations. A company which pay attention to social, ethical and environmental aspects perform better in relation to their value of shares (Hoogervorst 2009). On the other hand companies that neglect their social responsibility can have severe impact on shareholder value. Kanter (2004) in a study conducted in 23 countries with 23000 respondents, 90% reported they believed in broader responsibility than just profitability.

In response to the arguments by advocates of stakeholder model of governance, Australian Corporations and Market Advisory Committee (CAMAC) conducted a review in 2005 to analyse whether the Australian Corporations Act should be revised to incorporate directors to take into account, specific stakeholders or community interests in corporate decision making without breaching their duty towards shareholders of the company(CAMAC 2006). King of Code of Corporate Governance in South Africa advocates the stakeholder approach. Their Principle 1.1, recommendation 1.1.9 states *promote the stakeholder-inclusive approach.* Principle 1.2 states “*the board should ensure that the company is and is seen to be a responsible corporate citizen”*. Recommendation for principle is supported by recommendation 1.2.1 “*a board should consider not only on financial performance but also the impact of the company’s operations on society and the* *environment"*; and 1.2.2.states *"protect, enhance and invest in the wellbeing of the economy, society* and the environment"(Institute of Directors South Africa 2009).

The next section of this paper will discuss corporate disasters which had significant impact on humans and environment as a result of their failures in social responsibility.

CASE STUDIES

Bhopal Gas Tragedy: Case of Bhopal gas tragedy was a failure in corporate social responsibility, which resulted in a serious environmental disaster. One of the most deadly chemicals, MIC was stored and produced in a densely populated area by Union Carbide. Due to cost cutting, operation was of sub-standard, work force was cut down by half between 1980 and 1984, which had serious consequences on safety and maintenance. Many skilled workers and well-trained and experienced engineers and operators had left the Bhopal factory in search of more secure and satisfactory employment. In addition to the above they withheld medical information on the chemicals which deprived victims of proper medical care (Dinham & Sarangi 2002; Dutta 2002). According to unofficial sources, over 16000 have been killed. A study carried out by an NGO in March 1985 showed, 50% - 70% of the non-hospitalised population who were exposed, had one or more symptoms of MIC poisoning. A study conducted in 1993 for a in Delhi University showed 65.7% people were suffering from respiratory symptoms, 68.4% with neurological problems and 49% with ophthalmic symptom. 43.2% of women in the reproductive age suffered from reproductive disorders (Dutta 2002). This disaster was caused as a result of cost cutting and withholding medical information delayed the treatment for the victims. The impact on the community was disastrous. Corporation and its officers can be held liable criminally held liable under the Indian law. Plant manager of Union Carbide was arrested by the Indian Government and Chairman of Union Carbide board, Warren Anderson was charged with negligence and criminal corporate liability and criminal conspiracy when he arrived in India from United States (George 2012).

Exxon Valdez: In 1989, 11 million gallons of oil spilled into Alaska's Prince William Sound which was the largest ever oil spill killing thousands of sea birds, otters and other wild life. It also affected the Alaska's fisheries, National Park, beaches and forests and tourism. The crew master unable to give directions due to influence of alcohol, left the command of the ship under the third mate who was not licensed to pilot the vessel resulting in this disaster. Apart from the above they took a while respond to the spill as well as sending aid to Alaska. They only communicated to the people in Valdez but failed to report to the public at large. It was only after two weeks Chairman, Lawrence G. Rawl flew to the disaster site, and instead, he sent a team who were not trained in crisis management. Here again due to cost cutting experts were not available. They never took the responsibility, this proved that they did not care about the environment or the damage done to the tourism or the fisheries industry in Alaska (Ferrell, Fraedrich & Gwyneth 2011). According to the legal decision Exxon was liable for punitive damages of US $5billion and $507.5 million compensatory damages.

James Hardie Case: James Hardie case was the third case examined in this paper. James Hardie produced and distributed Asbestos products for most of the 20th century, even though the dangers from exposure to asbestos were not known till the 1930s. Exposure to asbestos fibres was linked to lung cancer and various respiratory diseases, which resulted in thousands of cases against James Hardie for negligence and product liability. James Hardie stopped using asbestos in any of their products by 1986 and in the late 1990s, board of directors decided to relocate to Netherlands to avoid liability against asbestos claims and also to receive favourable tax advantages. In 2001, the remaining companies in Australia were given funding to setup a Medical Research and Compensation Foundation to deal with asbestos liabilities. However, the funds were insufficient to meet the claims of those workers who were suffering exposure to asbestos with James Hardie products. In February 2001, an announcement was made by the directors of James Hardie to the Australian Securities Exchange (ASX), that the foundation had sufficient funding to meet the future compensation claims. The announcement was misleading, because it was underfunded by $1.5 billion. It was found that the directors were in breach of the duty of care and diligence under s 180(1) of *the Corporations Act 2001* (Cth) (de Saini ; Hargovan 2009; Harris, Hargovan & Adams 2008; King 2012). The directors of James Hardie adopted a policy to minimise the liabilities to thousands of victims, through restructure to maximize the interest of the shareholders. This demonstrates a clear tension between maximization of shareholder interest and other stakeholder interest (Harris, Hargovan & Adams 2008).

BHP and Ok Tedi: BHP is one of the world’s largest mining companies, operating in Ok Tedi Papua New Guineas resulting in impacting on the environment and the life style of the people in Ok Tedi.

During the construction of the tailing dam for the Ok Tedi mine, a slippage caused the foundation to collapse and an investment of $70 million was washed into the river. Papua New Guinea government gave permission to commence mining without a tailing dam. However, BHP promised to look for feasible options for tailing containment. Disposal of waste into the Ok Tedi River had impacted on the environment. A barge transporting 2-7 tonnes of cyanide sank into the Fly River killing fish and crocodiles, which were found down the stream. In 1989 toxic chemicals spilt into the river as a result of a burst pipeline. Life style of the people who were living along the river was also affected. In a statement made by the solicitors, Slater and Gordon representing the local landowners said *"The Villagers' subsistence lifestyle of thousands of years had been wiped out in the past decade by an environmental catastrophe"(Australian Graduate School of Management).*

Despite the above, benefits of Ok Tedi mine were its contribution to about 20% of the export income, provided employment for thousands of people, investment of $ 300 million in infrastructure such as roads, power, water, communications, schools and medical facilities, education and training for over 1500 people, infant mortality rate declined from 33% to 3%, improved health and increased life span from 30 to 50 years. It also expanded the educational opportunities for children, established school building and provided small business assistance. Therefore, closing the mine was not a solution as it was important to economic and social welfare of Papua New Guinea (Australian Graduate School of Management) .

BP Oils Disaster: This is the most recent, largest accidential oil spill in history affecting the environment. It extended to 339 miles, which required coastline required to clean up. It claimed 11 lives and oil flowed for 87 days. There was extensive damage to marine and wild life habitats, fishing and tourism industry and health problem, which has continued through to 2013. US government report in September 2011 on the spill stated, defective cement on the wall which was mainly blamed for BP, cost cutting and insufficient safety systems for its partners Transocean and Halliburton. The report also stated that poor risk management was the cause for loss of life and pollution of the Gulf of Mexico, last minute changes to plans, failure to observe and respond to critical indicators inadequate well control response and inadequate training on emergency bridge response by the companies and individual responsible. Plaintiffs' lawyers' states mishandling of a rig safety test, in adequate training of the staff, poor maintenance equipment and substandard cement. This case was filed by Department of Justice as " gross negligence and wilful misconduct" (Wikipedia).

Telstra: The most recent case was reported in May 2013, as a result of mishandling of asbestos during the rollout of the National Broadband Network. "The asbestos threat was known yet safety measures were inadequate". Workers and members of public were exposed to asbestos in the Telstra pits. Telstra had a duty of care to prevent to workers and public who may be in contact with asbestos. The exposure to asbestos is preventable if people who were qualified to do the work removed it. Telstra's chief executive Thodey accepted the responsibility as one for Telstra rather than the government.

DISCUSSION

The above cases poses the question where was the accountability of the boards and the officers that operated these companies. As in the Bhopal case withholding medical information was unethical and irresponsible by the directors and officers of the organisation. These cases also reported cost cutting, as in Exxon Valdez resulting in substandard work, BP oil and Telstra which resulted in insufficient safety systems and in Bhopal, reduction in staff resulted in unavailability of experts. Directors were in breach of their duty of care as a result of announcement of misleading information in James Hardie. In Ok Tedi, work of BHP resulted in polluting the Ok Tedi river and the life style of people living there. Where was their duty of care for the people, environment and the communities?

In the Ghopal case seven executives including the chairman were sentenced to only two years jail. The Ghopal tragedy, which left thousands dead and injured, was settled for US $470 million, which worked out for around Rs 10,000 per victim. Whereas in EXXON spent $40,000 for rehabilitation of every sea otter affected and each sea Otter was given a rations of lobsters costing US $500 per day. This shows that the value of life of an Indian Citizen in Bhopal was much cheaper than a sea otter in America (Dutta 2002).

Companies operating trans-nationally must act in a responsible manner even if there are no regulations prohibiting their acts in the country they are operating. Business ethics is aimed at inculcating to conduct businesses in a responsible manner by the employees of a company (Hurst 2004). Conducting businesses in a socially responsible manner applies to every type of business wherever they operate. Even though a business is run for the benefit of the shareholders, failure to take into account the other stakeholders can have a significant impact on the business and society as demonstrated in the case studies examined above. Therefore, directors who are the gatekeepers must be vigilant the way a business operates.

The legal framework does not talk about the interest of other stakeholders, other than the owners or shareholders of a company. As referred to above even though corporate governance codes recommend stakeholder interest should be considered in their decisions, the corporations' law does not punish the directors and the officers for wrong done to other stakeholders as a result of their activities. Corporations act and common law requires directors to have a duty to act in the best interest of the corporation, which is in the interest of shareholder. Operation of a company to increase shareholder value can have strong implications in the long run as discussed above. Cost cutting as in above situations to the benefit of the shareholders can be detrimental to the other stakeholders, which had an impact on the society and environment. These situations also impact the shareholder value and the corporate reputation.

CONCLUSION

Activities conducted by businesses can have both positive and negative impact on economy, society and environment. Impact on society and the environment as a result of corporate irresponsibility is still an issue even in the 2013 as reported in Telstra case. Maximisation of shareholder value under the shareholder primacy view can be questioned in the light of the above cases. Cost cutting, insufficient safety measures, announcement of misleading information and lack of duty of care for people, environment and the community have brought much attention on duties and responsibilities of directors and officers towards stakeholder approach. Under the Corporations Act directors have a duty to act in the best interest of the shareholders, however the issues encountered as result of activities of the firms studied had disastrous impact on the environment and the society, Corporations Act should include explicit obligations towards stakeholder affected by the activities of the firm. This paper is a preliminary evaluation of case studies on environmental disasters in relation to duties and responsibilities of directors' and officers' to other stakeholders, which will lead to a further study with a larger sample of companies.

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