

# Directors Duties and Responsibilities Towards Other Stakeholders: A Discussion of Case Studies on Corporate Disasters

Kumudini Heenetigala and Chitra Sriyani De Silva Lokuwaduge  
Victoria University, Australia

---

## ABSTRACT

Implications of corporate disasters as a result of irresponsible corporate actions/decisions have been significant. Impacts on the society and environment and their affects are seen after many years. Previous research on directors' duties and responsibilities towards stakeholders other than shareholders is scarce, due to the reason that the legislative requirement of directors is to act in the best interests of shareholders. 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 a 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 interests, the focus of corporations' laws is on shareholder value. Given that the impact of corporate disaster on society and environment 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 the ethical responsibilities of a corporation. Directors of high profile companies have been charged for failure of their duties of care, negligence and misconduct. The most recent case in the news was the asbestos threat as a result of mishandling by Telstra and NBN Co. in 2013. Complying with legislation and regulation has a strong influence in the way business operates. This paper argues that those corporations that are socially

responsible tend to operate in a manner that fulfils the wishes of society through legal and ethical behaviour.

Copyright © 2013 Victoria University. This document has been published as part of the Journal of Business Systems, Governance and Ethics in both online and print formats. Educational and non-profit institutions are granted a non-exclusive licence to utilise this document in whole or in part for personal or classroom use without fee, provided that correct attribution and citation are made and this copyright statement is reproduced. Any other usage is prohibited without the express permission of the publisher.

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. In the current legal

framework in Australia, under both the Corporations Act 2001 and 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).

In the case of corporate disasters such as Exxon Valdez, James Hardie, Bhopal Gas tragedy, BP oil spill, BHP and Ok Tedi and the National Broadband Installation, what were the duties of directors? If the duties of directors are to govern a corporation to ensure that the shareholders' interests 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 to employees and environment. Disasters do happen but acting for the betterment of one group at the expense of the others is an irresponsibility and not acceptable in the civil society.

According to CAMAC (2006, p. iii) "*A simplistic approach that focuses on one particular social perspective to the exclusion of others is unlikely to do justice to the complexity of corporate decision-making or the overall contribution of corporation to the society. A balanced approach under which companies are judged according to their overall economic and other contribution and impacts, including how they manage social and environmental issues relevant to their business, is more productive and meaningful.*"

This paper will analyse case studies on environmental disasters of six corporations located around the world in order to understand a company's responsibilities in relation to the 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. The Corporations Act specifies four main duties for directors, which are duty to act with care and diligence (s180), duty to act in good faith (s181), proper use of position (s182) and proper use of information (s183). 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 is meant by "interests of the corporation" (Marshall & Ramsay 2012). In the context of UK, amendments to address this was made to the UK Companies Act in 2006. 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, that would most likely 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 between members of the company' (Marshall & Ramsay 2012, p. 314).

Marshall and Ramsay (2012), further argued that section 172 of UK Corporations Act, emphasised that 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), who constructed the team production model of corporate governance, corporate law in the United States is more consistent with their model and that the legal conception of the company may already be largely consistent with the stakeholder conception. According to their argument 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

The theoretical perspective of this paper is based on a shareholder vs stakeholder approach. According to a “shareholder primacy” view, a corporation is run for the sole benefit of the shareholders. As a result, directors of a company have an obligation to maximize shareholder value through monitoring the agents who are the managers of the company. Friedman (1970) argued that a firm’s responsibility is primarily towards maximizing the wealth of the shareholders, 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), which also supports Friedman (1970) that Corporate Social Responsibility is married with a corporate profits motives to maximize shareholder value (Brueckner 2010).

Freeman (1984) presented stakeholder theory and developed the stakeholder governance model. Freeman’s ‘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 not only recognised the importance of ‘inputs’ and ‘outputs’, but also 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 and to involve them in how the company is run (Jensen 2001). The emerging literature explained the theory in detail. Donaldson and Preston (1995), outlined three distinct aspects of the theory as descriptive, describing 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. The normative or intrinsic value of the company is the core of stakeholder theory. (Marshall & Ramsay 2012). It considers stakeholders as the “end” while the other two aspects are regarded as “means” (Marshall & Ramsay 2012), i.e. how stakeholders’ value could be used to improve company performance (Allen 2001).

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

In response to the arguments by advocates of a stakeholder model of governance, the Australian Corporations and Market Advisory Committee (CAMAC, 2006) conducted a review in 2005 to determine whether the Australian Corporations Act should be revised to incorporate instructions to 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). The Code of Corporate Governance in South Africa advocates the stakeholder approach (Institute of Directors South Africa 2009). 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”

In order to understand the importance of moving towards a stakeholder approach, the next section of this paper will discuss incidence of corporate irresponsibility leading to corporate disasters which had significant impacts on people and the environment.

## CASE STUDIES

### Bhopal Gas Tragedy

The Bhopal gas tragedy in India was 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, the operation was sub-standard and the work force cut down by half between 1980 and 1984. This had serious consequences for 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, management 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 (Dutta, 2002). 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 dissertation 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).

Tragedies of this nature could be avoided if boards took more responsibility towards other stakeholders who would be impacted by the operation of the company. In the above case, the corporation and its officers were criminally liable under the Indian law. The 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

Exxon Valdez disaster was an environmental disaster, which had an impact on the environment affecting mainly animals. In 1989, 11 million gallons of oil spilled into Alaska’s Prince William Sound was the largest ever oil spill, killing thousands of sea birds, otters and other wild life and affecting Alaska’s fisheries National Park, beaches and forests and tourism. This environmental disaster occurred as a result of the irresponsibility of the crew master of the tanker carrying the fuel who was under the influence of alcohol and left the command of the ship to the third mate who was inexperienced and not licensed to pilot. Apart from the above, Exxon delayed responding to the spill or sending aid to Alaska. When the company did respond, it sent a team who were not trained in crisis management. Here, again due to cost cutting, experts were not available. The company communicated to the people in Valdez but failed to report to the public at large. It was only after two weeks that Chairman, Lawrence G. Rawl flew to the disaster site. The company board never took responsibility for the disaster, indicating a lack of 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

The third case examined in this paper is the James Hardie case. James Hardie was a company in Australia which produced and distributed Asbestos products for most of the 20<sup>th</sup> century. 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. By 1986, James Hardie stopped using asbestos in any of their products and in the late 1990s, James Hardie's 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 made by the directors of James Hardie to the Australian Securities Exchange (ASX), stated 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 James Hardie case directors adopted a policy designed to minimise the liabilities of the company to thousands of victims and a restructure policy that aimed to maximize the exclusive interests of the shareholders. This case demonstrates a clear tension between maximization of shareholder interests and other stakeholder interests (Harris, Hargovan & Adams 2008).

### **BHP and Ok Tedi**

BHP is one of the world's largest mining companies, operating in Ok Tedi Papua New Guinea. 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 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-stream. In 1989 toxic chemicals spilt into the river as a result of a burst pipeline. The life style of the people who were living along the river was also affected. In a statement, 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, Ok Tedi mine contributed 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, reduced the infant mortality rate 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 the economic and social welfare of Papua New Guinea. BHP was proud of its' achievement at OK Tedi, but recognised the difficulties that the mine created due to its impact on the environment and the effect of the lifestyle on the people living along the river. However, closing the mine was not an option, as it was too important to economic and social welfare of the people in Papua New Guinea and negative impact was only advocated by a very small number of people in the region. Therefore, BHP declared that it is committed to carrying out all aspects of its operations in a responsible manner as well as adopting equal standards in all the countries and communities they operate. In 1996, out of court settlement of \$400 million was agreed for the land holders, which included compensation of \$110 million, \$40 million to relocate 10 villages and legal expenses of \$7.6 million. Apart from the above, BHP agreed to sell ten percent of OTML to the government of PNG for the benefit of the local community. (Australian Graduate School of Management).

### **BP Oil Disaster in the Gulf of Mexico**

This is the most recent, largest accidental oil spill in history extending to 339 miles, requiring coastline clean up, claiming 11 lives and oil flowing 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. The US government report in September 2011 on the spill stated that , defective cement in a well which was mainly due to BP and its partners Transocean and Halliburton cutting costs and installing insufficient safety systems. The report also stated that poor risk management was the cause of 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's responsible. Plaintiffs' lawyers' identified mishandling of a rig safety test, inadequate training of the staff, poor maintenance equipment and substandard cement. This case was filed by Department of Justice as "gross negligence and wilful misconduct" (Fisk & Calkins 2013; Wikipedia)

## **Telstra National Broadband Installation**

The most recent case reported in May 2013, was a result of mishandling of asbestos during the rollout of the National Broadband Network. "The asbestos threat was known, yet safety measures were inadequate" (Crowe 2013). Workers and members of public were exposed to asbestos when Telstra was installing the cables. Telstra had a duty of care to prevent 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 (Jacques 2013). As a result, a national register was established to enable public to contact if they were exposed to asbestos. They also appointed a Telstra Network construction executive director to oversee all asbestos management, including compliance. They have also taken steps to confirm that employees conform to best practice in asbestos management and contractors and subcontractors meet the standards under the Federal Code of Best Practice and implemented extra checks, controls and training as well as extra people to ensure that work is carried out in the most safest manner (Lion 2013).

## **DISCUSSION**

The above cases pose the question of where was the accountability of the boards and the officers that operated these companies. In the Bhopal case withholding medical information by the directors and officers of the organisation was unethical and irresponsible. Cost cutting, in Exxon Valdez resulting in substandard work, BP oil and Telstra approved 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 the announcement of misleading information in James Hardie. In Ok Tedi work in the mine by BHP resulted in polluting the Ok Tedi river and damaging the life style of people living there. Where was their duty of care for the people, environment and the communities?

The consequences for the companies varied. In the Bhopal case seven executives including the chairman were sentenced to only two years jail. The Bhopal tragedy, which left thousands dead and injured, was settled for US \$470 million, which worked out for around Rs 10,000 per victim. Following the disaster in Alaska EXXON spent \$40,000 for rehabilitation of every sea otter affected and each sea Otter was given a ration 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). Even though a business is conducted 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 interests of other stakeholders, other than the owners or shareholders of a company. As referred to above corporate governance codes recommend stakeholder interests and should be considered in their decisions but the corporations' law appears reluctant to punish the directors and the officers for wrong done to other stakeholders as a result of their activities.

They hide behind the Corporations Act and common law which require directors to have a duty to act in the best interests of the corporation, which is in the interest of shareholders.

## CONCLUSION

Activities conducted by businesses can have both positive and negative impacts on an economy, society and environment. 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 to the value of a stakeholder approach. Under the Corporations Act directors have a duty to act in the best interest of the shareholders. However, the issues encountered, as a result of the activities of the firms studied had disastrous impacts on the environment and the society. This paper argues that the evidence from the case studies suggests that the Corporations Act should include explicit obligations towards stakeholders affected by the activities of a firm.

## REFERENCE

- Allen, WT 2001, 'The Mysterious Art of Corporate Governance: How individual directors set the tone of the board', *Corporate Board*, vol. 22, pp. 1-5.
- Australian Graduate School of Management *The Environment: BHP and OkTedi*, <[http://www.agsm.edu.au/bobm/teaching/BE/Cases\\_pdf/Ok\\_Tedi.pdf](http://www.agsm.edu.au/bobm/teaching/BE/Cases_pdf/Ok_Tedi.pdf)>.
- Blair, MM & Stout, LA 1999, 'A team production theory of corporate law', *Virginia Law Review*, pp. 247-328.
- Brueckner, M 2010, 'Sustainability: A Corporate Responsibility', in *The Business with the Environment: A (Different) Reader*, 2nd edn, p. 27.
- CAMAC 2006, *The Social Responsibility of Corporations*, Corporations and Market Advisory Committee, Sydney, NSW.
- Crowe, D 2013, 'Union urges halt to NBN rollout over asbestos safety ', *The Australian*, 05 June.
- de Saini, NX 'Lessons for Directors, Company Secretaries and Corporate Advisors: The James Hardie Cases', *Astuto Lawyers*, viewed 12 June 2013, <<http://www.astutolawyers.com.au/james-hardie-case-summary/>>.
- Dinham, B & Sarangi, S 2002, 'The Bhopal Gas Tragedy 1984 to? The Evasion of Corporate Responsibility', *Environment and Urbanization*, vol. 14, no. 1.
- Donaldson, T 1983, "Constructing a Social Contract for Business" in Donaldson, T and Werhane, P. (Eds), *Ethical Issues in Business*, Prentice-Hall, Englewood Cliffs, NJ.
- Donaldson, T & Preston, LE 1995, 'The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications', *Academy of Management Review*, vol. 20, no. 1, pp. 65-91.
- Dutta, S 2002, *The Bhopal Gas Tragedy*, ICFAI Centre for Management Research, Hyderabad, India.
- Ferrell, OC, Fraedrich, j & Gwyneth, MV 2011, 'The Wreck of the Exxon Valdez', <<http://danielsethics.mgt.unm.edu/pdf/Exxon%20Valdez%20Case.pdf>>.
- Fisk, MC & Calkins, LB 2013, *BP Gulf of Mexico Spill, From Disaster to Trial: Timeline* Bloomberg.
- Freeman, RE 1984, *Strategic Management: A Stakeholder Approach*, Pitman Publishing, Boston, MA.
- Friedman, M 1970, 'Social Responsibility of Business is to Increase Profits', *New York Times Magazine*, 13 September, p. 33+.
- George, D 2012, 'Corporate Moral Responsibility: The Bhopal Incident ', paper presented to Angelo State University Symposium.
- Hargovan, A 2009, 'Corporate Governance Lessons from James Hardie', *Melbourne University Law Review*, vol. 33, pp. 984-1021.
- Harris, J, Hargovan, A & Adams, M 2008, 'Directors' and Officers' Duties', in *Australian Corporate law*, LexisNexis Butterworths, Australia.
- Hoogervorst, JAP 2009, 'Corporate Governance', in *Enterprise Governance and Enterprise Engineering*, Spring, Netherlands.
- Institute of Directors South Africa 2009, *King Code of Governance for South Africa 2009*, Institute of Directors South Africa,, South Africa.

- Jacques, O 2013, 'Disturbing Discovery of Asbestos at Busy Intersection', *Sunshine Coast Daily*.
- Jensen, M, C. 2001, 'Value Maximization, Stakeholder Theory and the Corporate Objective Function', *Journal of Applied Corporate Finance*, vol. 14, no. 3, pp. 8-21.
- Kanter, RM 2004, *Confidence*, Crown Press, New York.
- King, M 2012, 'Asbestos caser: James Hardie Directors banned, fined', *Nine News*, 12 November 2012.
- Lion, P 2013, 'NBN assesses rollout delays after asbestos scare ', *News Corp Australia Network*, 02 June.
- Marshall, S & Ramsay, I 2012, 'Stakeholders and directors' duties: Law, theory and evidence', *University of New South Wales Law Journal*, vol. 35, no. 1, p. 291.
- Newman, S, H, Stavis, G, N & Renick, J 2005, 'Fiduciary Responsibilities of Corporate Directors and Officers in the "Zone of Insolvency"', *Business Law Journal*, vol. 9, no. 1, pp. 24-30.
- Wikipedia *Deepwater Horizon oil spill*, <[http://en.wikipedia.org/wiki/Deepwater\\_Horizon\\_oil\\_spill](http://en.wikipedia.org/wiki/Deepwater_Horizon_oil_spill)>.