



Retrospective

Controversial Business Practices in 2019

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January 9, 2020

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Executive Summary

Inrate manages a database with more than 15,000 controversial business practices of over 3,000 companies of major indices such as MSCI Developed Markets, MSCI Emerging Markets and the Swiss Performance Index collected over nine years. News articles are screened on a daily basis, recorded, categorized as well as evaluated in detail.

As the year comes to a close, we have taken some time to reflect upon the controversies of 2019 and have compiled a list of five controversial business practices, which caught our attention during the last twelve months. Every chosen example is extraordinary in nature, even though for different reasons. The list includes controversies that were relevant because of the impact of the corporate conduct on the environment and society as well as the perception of stakeholders thereof. Some of the controversies that emerged in 2019 or earlier saw significant updates during the past year. It is not necessary to compile a ranking of the controversies with the highest grades of 2019. As in previous years, 2019 witnessed misconducts by corporations across a wide range of topics. Companies have been at the center of attention of the revelations in the wake of increasing public scrutiny.

Mining company Vale was at the center of a dam collapse with a disastrous impact on the environment and communities. The mudslide killed almost 300 people, destroyed large parts of native forest and polluted 300 km of river.

Two plane crashes occurred within a period of a few months, for which aircraft manufacturer Boeing was held responsible due to a lack of internal safety oversight. The death toll of these accidents exceeded 300 people. Entertainment and toy manufacturing company Mattel Inc. recalled nearly 5 million baby cradles. The company faced several lawsuits alleging that the product contributed to the death of infants. Both cases were caused by flawed and defective products.

A number of chemical and pharmaceutical companies, including Dowdupont Inc. (former Dow Chemicals) and Merck KGaA were criticized for a weak supervision of their supply chains. A disastrous explosion occurred at a facility operated by a Chinese supplier of chemical products.

Finally, credit reporting agency Equifax agreed to pay a record settlement of USD 700 million over a data breach. The controversy was at the center of emerging public discussions around data governance and the companies' lack of accountability as well as readiness for security lapses. This was a particularly interesting case as the company not only held a large amount of data, but also because highly sensitive information was exposed.

All of the listed controversies are examples of corporate irresponsibility causing far-reaching consequences for stakeholders involved. Moreover, such accidents pose considerable reputational as well as financial risk for the respective businesses.

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Vale

Deadly dam collapse in Brumadinho (Brazil)

Topic: Controversies over local communities / Impact on local communities

In January 2019, a mining waste tailing dam of Vale S.A. collapsed in Brumadinho, Minas Gerais, Brazil. Nearly 300 people died in the accident as 12 million cubic meters of sludge covered the town at a speed of 80 km per hour (The Guardian 2019a, Politize 2019). The non-governmental organization Greenpeace called the mudslide an environmental disaster. According to the NGO, an area of 138 hectares of native forest was destroyed and more than 300 km of the river Paraopeba was improper for human and animal consumption (Greenpeace 2019). The CEO of Vale apologized shortly after the incident without clearly taking responsibility. Vale stated that the TÜV Süd, a certification body, had conducted assessments related to the stability of the dam in June and September 2018. The authorities froze assets of Vale worth USD 1.3 billion after the incident in order to compensate victims and "pay for rescue efforts" (The Washington Post 2019).

Later in January 2019, the Brazilian police arrested three Vale employees and two subcontracted engineers of TÜV Süd. It was also reported that three US firms were preparing to file a class-action lawsuit against Vale (The Guardian 2019b). In February 2019, eight employees of Vale were arrested as part of the criminal investigation into the dam collapse (BBC News 2019a). Further on in July 2019, a judge in Brazil ordered Vale to pay for the damages caused by the dam collapse without citing a specific amount and Vale agreed to pay more than USD 100 million to the affected families (The Washington Post 2019, NPR 2019).

In September 2019, Brazilian police charged employees of Vale and the German safety-certification company TÜV Süd of "fraudulently attesting to the safety of the dam" (The Washington Post 2019). Police officials further argued that both companies were aware of the danger facing the dam, but tried to cover it (The Washington Post 2019). According to company documents, in 2018 sediment was found in the drainage water, which is a worrying sign and the National Mineral Agency must be informed (BBC News 2019b). In November 2019, the National Mineral Agency in Brazil reported that Vale failed to report these warning signs (BBC News 2019b).

Inrate's view: Inrate considers this event as severe since nearly 300 people died and serious environmental damage was caused. Furthermore, this is the second dam burst Vale is responsible for with severe consequences for humans and the environment. The company is responsible for two major environmental disasters with numerous fatalities in Brazil in the last years, as the mining dams were obviously poorly maintained, indicating a systematic lack of safety measures. Further, the legal investigations suggested that the company had tried to cover the safety deficiencies together with the safety-certification company TÜV Süd. Based on this evidence, it has to be assumed that also other tailing dams in Brazil are at risk of collapsing.

Boeing

Crashes of 737 Max 8 aircrafts (Indonesia and Ethiopia)

Topic: Public impact of products & services

At the end of 2018, Boeing was sued by several families that lost their family members in a fatal plane crash of Lion Air. The accident occurred two months prior and killed 189 passengers on board (Reuters 2019a). The lawsuits alleged that operating the aircraft 737 Max-8 was dangerous due to inconsistent information regarding changes made to the said aircraft model. At that time, Boeing declined to comment on the litigations. In March 2019, an Ethiopian plane crashed only few minutes after taking off. The death toll exceeded 150 people. Again, the accident was caused by the same aircraft model manufactured by Boeing. After the second severe plane crash within few months, a number of carriers had grounded their airplanes of the same model over safety concerns (The Guardian 2019c).

Further investigations found out that the Maneuvering Characteristics Augmentation System (MCAS) developed by Boeing was faulty. Black box data for the Lion Air flight suggested that the system pushed the planes' nose downward each time the pilot tried to pull the plane up. Moreover, it was reported that Boeing pushed for the approval of the model in 2015 in order to be ready to compete with the comparable model by Airbus. The company thus carried out a self-certification process. The Federal Aviation Administration (FAA) reportedly pressured safety engineers and handed over assessments for the control system to the company itself (Intelligencer 2019). Also, Boeing decided to not train pilots on the control system MCAS, while also not being mentioned in the aircrafts' manual. After acknowledging the fact that there were clear similarities between the two crashes, Boeing decided to redesign the software (BBC 2019c).

As of November 2019, the 737 Max fleet, consisting of approximately 400 planes, remained grounded worldwide (CNBC 2019). In December, it was reported that the production would be temporarily halted as regulators were reluctant to clear the grounded airplane. Boeing faced a number of lawsuits and was forced to compensate

airlines for the loss in services resulting in considerable financial losses (NZZ 2019). Later in December, Dennis Muilenburg was forced to step down with immediate effect from his position as CEO (The New York Times 2019).

Inrate's view: Inrate considers this controversy as significant not only due to the fact that 346 people died in two plane crashes within five months, but also due to the circumstances that eventually lead to the accidents and the role Boeing played. Although investigations are ongoing, the company's integrity in this case needs to be questioned for several reasons. The aircraft manufacturer allegedly rushed the market introduction of the model, putting profit over safety. Further, the company appeared to ignore warnings and underestimated the difficulties pilots could be facing with the controlling system.

Equifax

Company's customer data hacked (US)

Topic: Controversies over content and privacy of customers' data / Commercial practices

In September 2017, the consumer credit reporting agency Equifax reported to be hit by a cyberattack where cybercriminals gained unauthorized access to the company's own network and stole data from 150 million consumers in the US and Canada (Chicago Business 2019). The data breach exploited a software flaw, which was only detected six weeks after the incident and exposed social security numbers and other personal information. Shortly after, the CEO and several other executives resigned in the course of the investigation (Bloomberg 2017).

In February 2018, it was revealed that the data breach leaked tax identification numbers, email addresses, credit card information and driver's license information, which was more data than the company initially reported (The Wall Street Journal 2018). In June 2019, former employees pleaded guilty of insider trading, selling stocks just before the data breach (Marketwatch 2019).

Recently, Equifax agreed to pay around USD 700 million to settle with the Federal Trade Commission

to resolve the investigation over the breach, alleging that the credit agency failed to take reasonable steps to secure their network. The settlement included a compensation to the affected customers, 40 states territories and to the U.S. Consumer Financial Protection Bureau (FTC 2019). Additionally, the company agreed to spend USD 1 billion to strengthen its data security infrastructure and have its policies assessed by a third party. The settlement was the largest ever paid for a data breach (Chicago Business 2019).

Inrate's view: Equifax is among the largest credit reporting agencies in the US, which assesses the financial situation of most US citizens. Due to the nature of its business, Equifax handles large amount of data. Therefore, the company is to be held accountable in case of failing to protect data and implement appropriate best practices. The sheer number of affected customers made this breach one of the biggest in history, affecting almost half of the US population (Cnet 2017). However, solely considering the scale would be too short sighted. Inrate considers this controversy as significant due to the fact that highly sensitive data, such as social security numbers and dates of birth, were compromised. Moreover, the company's response to the incident was highly questionable and executives were accused of corruption (CSO 2019). The fact that the company agreed to pay the highest ever settlement for a data breach earlier this year underscores this conclusion.

Dowdupont Inc. (former Dow Chemicals), BASF, Clariant, Merck KGaA, Lonza

Explosion at a chemical plant killed workers (China)

Topic: Health and safety (contractors)

On March 21 2019, 78 people were killed and over 600 people suffered injuries due to an explosion at the Chinese chemical factory Jiangsu Tianjiayi Chemical Co., Ltd. (JTC), allegedly due to weak

safety measures in the factory. In fact, the firm counted 13 safety and environmental violations (e.g. illegal pipeline installation to emit pollutants, absence of emergency shut-off valves, etc.), which were documented in 2018 by the State Administration of Work Safety¹ (IPE 2019).

The deadly explosion had involved, according to a report published by the Chinese environmental group called Institute of Public and Environmental Affairs (IPE), several Western corporations, i.e. the global chemical and/or pharmaceutical giants Dowdupont Inc.², BASF, Clariant, Merck KGaA and Lonza (IPE 2019).

In May 2019, the IPE had criticized the abovementioned international firms for the "irresponsible operations" they have been conducting in China, where several major accidents at chemical plants had occurred (Reuters 2019b). Therefore, the institute asked them to reconsider their procurement policies to stop outsourcing business to suppliers in China who violate safety regulations. As a matter of fact, these firms were deemed liable for the dangerous conditions at the JTC plant, which counted several documented safety and environmental breaches (IPE 2019). The investigations led to the detention of 26 people (Reuters 2019c). According to the local government, several JTC's employees and workers from "intermediary organizations" were accused of performing false evaluations of the firm's operations (Reuters 2019d). Furthermore, the plant was shut. Consequently, Western buyers like Lonza, for whom JTC represented an important supplier, had to suffer shortages of raw materials. According to the IPE (2019), some firms have shown a reluctance to declare their relationship with JTC. For instance, Dowdupont Inc. had denied any business relationship with JTC, even though DuPont had implied, in an internal communication with Dow that JTC is an indirect supplier. Furthermore, BASF had communicated that JTC was not a supplier, while IPE implied that it was an indirect supplier of the company. Finally, Merck KGaA and Clariant have indicated or implied that JTC is a second-tier supplier.

This controversial event had initiated a discussion about the risks involved in the purchase of

¹ Current Ministry of Emergency Management

² The company split on April 22, 2019 into Dow and DuPont

materials from Chinese firms that do not comply with the existing local regulatory frameworks.

Inrate's view: This controversy highlights the urgent need for Western companies to conduct their due diligence within the supply chain and to reevaluate their procurement practices, whether the relationship with the contractor is direct or indirect. For instance, this case reveals a weak supervision of the firms over their suppliers. Inrate considers this controversy significant as these procurement operations, realized with disregard of the suppliers' compliance with safety and environmental laws, had led to many deaths and a significant number of injuries among the contractors. Furthermore, the shortages of raw materials linked to this kind of controversy had an important effect on the reliability of the production, with the resulting implication on the economies in which they operate.

Mattel Inc.

Recall of Rock 'n Play sleepers over safety issues (US)

Topic: Health impact of products and services

In April 2019, the American Academy of Pediatrics (AAP) urged the U.S. Consumer Product Safety Commission (CPSC) to recall baby sleepers produced by the company Fisher-Price, a subsidiary of Mattel, Inc., as babies died by rolling over under uncontrolled circumstances. Plaintiff families, that joined to sue the company, declared that their babies died because of suffocation (Bloomberg 2019).

Rock 'n Play sleepers were marketed as an effective way to help babies to fall asleep, which contributed to their popularity among sleep-deprived parents. Some parents were also under the conviction that the sleepers could provide relief from infants suffering with acid reflux (Vox 2019).

As the sleepers were linked to 32 infant deaths between 2011 and 2018, the AAP alerted parents to stop using the sleepers. AAP has considered the product as non-compliant with the academy's recommendations regarding an infant's safe sleep environment, according to which babies should

sleep on a flat and firm sleep surface. However, Fisher-Price Rock 'n Play sleeper had an inclined surface, which restrained the babies' movements (AAP 2019).

Fisher-Price reacted three days after AAP's news release by recalling all models of Rock 'n Play Sleepers, which added up to nearly 5 million infant sleepers. The AAP alleged that, although being aware of the risks related to the product, the company and the Consumer Product Safety Commission (CPSC) did not take any actions to avoid fatalities (NZ Herald 2019, Bloomberg 2019). For instance, their product was banned in 2011 by the Canadian and Australian governments and the company had received a plethora of warnings by concerned parents and pediatricians (Bloomberg 2019).

Inrate's view: Inrate considers this product liability case to be a significant controversy because the sleepers have stayed on the market for a long time even though their characteristics were deemed to be life-threatening for infants, which eventually cost several lives. The company would have had the opportunity to recall the dangerous product earlier but reacted only after AAP urged the recalling based on over thirty cases of infant deaths.

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