RepRisk and GEC Risk Advisory

Joint Special Report on Negligence

November 2015

Foreword from RepRisk CEO

I am pleased to introduce our Special Report on Negligence, our second joint report with our partner, GEC Risk Advisory.

Negligence is a crucial issue for any corporation. If a court rules that a company or corporation has been negligent, the business can be liable for financial damages and subject to fines in the form of punitive damages. In severe cases, particularly those that cause serious injuries or fatalities, a business can even lose its license to operate. When negligence leads to a serious accident, the victims might also seek redress by filing negligence lawsuits against the entity's staff members, claiming that their oversight contributed to the incident.

Negligence is one of the 39 RepRisk Topic Tags – "hot topics" or themes related to environmental, social, and governance (ESG) issues. Users of the RepRisk ESG Risk Platform have the ability to research these specific issues of interest to identify and assess which companies, projects, and other entities are linked.

This report presents case studies on different aspects of negligence, together with an analysis of how these violations could affect the companies involved. The aim of the report is to increase awareness of an issue that is sometimes overlooked.

Philipp Aeby
CEO, RepRisk AG

Foreword from GEC Risk Advisory CEO

In this second joint report by RepRisk AG and GEC Risk Advisory, we provide case studies and an analytical view of the critically important topic of negligence, which manifests itself in a variety of ways and – in the cases reviewed – in diverse locations, ranging from the US and Brazil, to Russia and China.

The word negligence may have different meanings in different cultures, as well as specific legal meanings in the jurisdictions in which an organization or company may be operating. The Oxford Dictionary provides the following two generic definitions:

- Noun: Failure to take proper care in doing something.
- Legal: Breach of a duty of care, which results in damage.

A key theme throughout this report is that reputation risk can amplify and worsen the negative implications of negligence when organizations are found to have been careless or unprepared for the underlying risk — environmental, safety, corruption — that led to negligent acts or omissions. The way we use the word negligence is very close to the above definitions. As we review the various cases of negligence, it is important to note that we mean it in the most general and generic sense of alleged, potential, or actual acts or omissions by various possible actors that have led or may lead to damage or harm to people and property. In some cases, applicable courts have identified negligence as the applicable cause of legal action. In other cases, the facts are still recent and/or under investigation, so while negligence is possible, it may or may not be ultimately proven.

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Contents

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Introduction

This Joint Special Report on Negligence analyzes five cases that each highlight a different set of circumstances that have led to accusations of negligence. The cases stem from different sectors and geographies, and are linked to both publically-traded companies and private companies as well as governmental bodies.

These cases were each taken from the RepRisk ESG Risk Platform, the most comprehensive database on environmental, social, and governance (ESG) risks linked to companies, projects, sectors, and countries. Every day, RepRisk screens over 80,000 media and stakeholder sources in 15 languages to systematically capture and analyze ESG risk incidents that can lead to potential reputational, compliance, and financial risks.

Each case study has two components: The first is a summary of the risk incident provided by RepRisk. The second is a practical and interpretative analysis on how these risks could affect corporates and organizations, provided by GEC Risk Advisory.

Case study	Company	Sector	Country	Topic	Related Issues
1	RUIHAI INTERNATIONAL LOGISTICS CO. (public/private)	Chemicals	China	Tianjin explosion: Illegal, toxic waste stored in urban environment; explosion leading to numerous deaths and major destruction	-Corruption and bribery -Impacts on communities
2	MAGELLAN OOO (public)	Aerospace and Defense	Russia	Capsize of Dalniy Vostok trawler: Maritime disaster; safety violations	-Corruption and bribery -Occupational health and safety issues
3	FREEDOM INDUSTRIES INC. (private)	Mining	USA	Elk River spill: Coal mining; toxic emissions polluting water supply	-Local pollution -Impacts on ecosystems and landscapes -Impacts on communities -Occupational health and safety issues
4	CONSTRAN - UTC ENGENHARIA (private)	Construction and Materials; Industrial Transportation	Brazil	Construction accident: Safety violations cause fatalities	-Occupational health and safety issues -Poor employment conditions
5	DUKE ENERGY CORP. (private)	Utilities	USA	Dan River spill: Environmental waste	-Impacts on ecosystems and landscapes -Local pollution

Case 1 China detains municipal officials and Tianjin Port executives in connection to deadly blast at Rui Hai warehouse

Company: Ruihai International Logistics Co. (public/private)
Sector: Chemicals
Country: China

RepRisk Incident: Negligent storage of hazardous chemicals, August 2015

According to China's Supreme People's Procuratorate, 11 municipal officials as well as executives from state-owned Tianjin Port have been detained in connection with the fatal explosion that took place on August 12, 2015 at a chemical warehouse operated by Ruihai International Logistics (Rui Hai) in Tianjin. The incident killed more than 145 people and prompted intense anger among residents, as their homes were damaged, and they feared health risks from the hundreds of tons of hazardous chemicals at the blast area. Reportedly, work safety officials and Tianjin Port officers failed to detect and penalize safety breaches of Rui Hai, which had violated safety laws by operating a toxic chemical warehouse within hundreds of meters of a densely populated area. The executives of Rui Hai have already been taken into custody. The 11 recently detained officials are facing accusations including dereliction of duty, abuse of power, illegal issuance of permits, and failing to properly regulate and supervise businesses that handle hazardous chemicals, although it is not yet clear whether formal charges have been filed. Separately, the head of China's work safety agency has been fired after being placed under investigation for corruption.

GEC Risk Analysis:

Although the facts of this case continue to unfold, a review of what we know so far provides a variety of preventative lessons that companies, executives, and government agencies alike can consider, especially those in industries that involve activities that could potentially endanger life and property.

Key takeaways and observations:

Critical industries: Industries that have potentially serious and material environmental, health and safety (EHS) issues that can adversely affect their employees, customers, and the surrounding communities, have a higher duty of care, whether it is actually required by law or not. Clearly the chemical sector is such an industry – whether companies are privately owned, publicly- listed, or quasi-governmental – given the highly hazardous nature of its processes and products.

Management responsibility: The management of these critical types of industries must exercise a higher duty of care – whether or not it is required by laws and regulations, and regardless of whether the law is actually enforced.

Director oversight: The boards of directors or other applicable governance entities of such critical industries cannot be passive oversight bodies. The fact that life and limb are at risk if proper care is not embedded into safety processes and controls within the organization should drive such governance bodies to take a more proactive stance about the EHS controls and risk management programs within the organization. This is crucial if they wish to protect both the reputation of their company and their own reputations.

Centrality of stakeholders: In this case, the critically affected stakeholders were employees and the community near the toxic waste facility that was allegedly violating existing law due to corrupt practices. Any company or facility that has dangerous activities must have a heightened sensitivity to their potential impact on communities and other important stakeholders.

Corruption risks. Frequently associated with cases of EHS negligence is the presence of some form of corruption or fraud that allows the violations to go unchecked. This appears to be the case here.

Case 2 Russian authorities complete investigation into sinking of Magellan’s Dalniy Vostik trawler

Company: **Magellan OOO (public)**
Sector: **Aerospace and Defense**
Country: **Russia**

RepRisk Incident: Poor safety management causes fatalities, August 2015

The Russian Investigative Committee has completed its probe into the sinking of Magellan’s Dalniy Vostok trawler on April 2, 2015 in the Russian Sea of Okhotsk, which resulted in the deaths of 69 sailors. According to the investigation, an executive of Sakhalinrybflot, a ship-leasing firm, negligently allowed the trawler to leave the Sakhalin port without proper documentation. An inspector from the Federal Agency for Fisheries also reportedly accepted a bribe in exchange for a fictitious examination of the vessel. Magellan executives and the captain of the trawler have also faced accusations related to poor safety management, which resulted in loss of life. Reportedly, the trawler sank while the sailors were trying to load a 130-ton container onto the already overloaded ship. The authorities have seized RUB 13 million (USD 200,000) from Magellan’s accounts as well as two ships worth USD 4 million in order to compensate the victims’ families.

GEC Risk Analysis:

Negligence clearly is not limited to the private sector. This sad case demonstrates how a lack of proper government or regulatory supervision, or enforcement of laws and regulations, can lead to deadly incidents even in the government/military sector, incidents that might have been prevented if the required safety checks and care had been applied.

Key takeaways and observations:

Safety for all sectors: Safety is not optional. Whenever health and safety are involved, those on the supervising end and those on the receiving end should do everything necessary to complete their safety checklist even when it seems tedious. Failure to do this may result in a safety issue being overlooked, or not identified in time to save people and assets.

Commitment from the top: Whether it is for a company, a government agency, or a military unit, safety has to start at the top of the organization. A culture of safety needs to begin with the CEO and the Board, which has to be proactive about holding the management accountable, particularly when it comes to high-hazard industries or activities.

Foster communication: All organizations benefit from a “safe to speak up culture” where there is little or no fear of retaliation for raising concerns. A culture of safety can be contagious, and with the right encouragement, training, and communication, employees and others can help find and solve problems before they occur.

Corruption risks: Here is yet another case of corruption leading to fatalities. When people talk about corruption as a petty crime, they do not understand that corruption – when it is in the form of government safety regulators being paid to ignore situations of non-compliance – can lead to deaths and injuries, as well as extensive property damage.

Case 3 Former president of Freedom Industries faces fine and prison sentence over toxic spill

Company: Freedom Industries Inc. (private)
Sector: Mining
Country: USA

RepRisk Incident: Chemical spill contaminates drinking water, August 2015

On August 19, 2015, the former president of Freedom Industries pleaded guilty to pollution charges and negligence in connection with a chemical spill that contaminated drinking water for 300,000 people in the US state of West Virginia. The former executive, who is the last of six company officials to be charged in the case, reportedly faces a fine of up to USD 300,000 as well as a three-year prison sentence. On January 9, 2014, an allegedly rusty tank owned by Freedom Industries leaked MCHM, a coal-cleaning chemical, into the Elk River. The spill prompted a ban on using tap water in nine counties that lasted several weeks. Apparently, more than 100 individuals needed medical treatment for symptoms such as nausea and vomiting.

GEC Risk Analysis:

Higher-risk industries require a higher degree of care for life and property. Here is a clear case of negligent leadership where the top of an organization – in this case the former president of the company together with other former executives – pleaded guilty to pollution charges and negligence in connection with contaminating the drinking water of 300,000 people in West Virginia.

Key takeaways and observations:

Board accountability: The role of the Board is critical in high-hazard industries – they cannot be passive about EHS issues. They must hold the CEO accountable not only for financial targets, but for non-financial targets such as EHS issues.

Culture risk: This case shows what happens when there is a high-risk culture. When leadership is able to flaunt or ignore EHS laws and regulations, it is clear that there is a pervasive culture failure where "safe to speak up" is an unknown concept.

Leadership risk: Few enterprise risk management systems take into account leadership and culture failure risk, but both are strategic risks that can lead to material and even catastrophic consequences. In this case, it led to most of the existing leadership being terminated and some of them being prosecuted.

Role of internal audit: Internal audits should play an even broader role in high-hazard industries. In other words, a more sophisticated and broader range of internal audit capabilities should be deployed in this type of industry because of the safety, quality, and environmental repercussions of failing to observe proper standards. A broadly resourced internal audit team with EHS capability can discover problems before they erupt into calamities such as this one.

The role of external experts: Likewise, external audit firms with expertise on EHS should be deployed to test these areas periodically for the same reasons elucidated in the previous point.

Case 4

Constran-UTC Engenharia charged with the deaths of two workers due to lack of safety measures and negligence in Brazil

Company: **Constran-UTC Engenharia (private)**
Sector: **Construction and Materials; Industrial Transportation** **Country:** **Brazil**

RepRisk Incident: Lack of safety measures causes fatalities, August 2015

Following a complaint filed by the Brazilian Public Ministry of Labor of Goias, the Regional Labor Court of Quirinopolis has imposed a fine of BRL 1.3 million (USD 335,000) on Constran-UTC Engenharia for lack of safety measures and negligence at the workplace, which reportedly caused fatalities. In 2011, two employees of a Constran subsidiary died in an accident while working on the construction of the North-South Railway. The prosecutors have blamed Constran for failing to take adequate safety measures, including a failure to provide appropriate signs and proper training, and for subjecting employees to excessive working hours. According to another investigation carried out by the labor authorities of Quirinopolis, Constran failed to comply with 25 safety measures, which resulted in a "degrading and exhausting" workplace environment. Apart from the fine, the judge has ordered Constran to implement 36 safety measures, and has imposed a fine of BRL 50,000 (USD 12,800) for each incident of non-compliance.

GEC Risk Analysis:

In this case involving failure of safety on a construction site for a railway, we find yet another case of two industries – construction and transportation – that have a distinct need for higher awareness and care for health and safety than do some other industries (such as an office-based technology company). And once again, local courts in this case have found that negligence with regard to safety measures was a root cause of the fatalities.

Key takeaways and observations:

Building a safety culture: A safety culture comes from the top and is not necessarily driven by laws and regulations. While laws are always important incentives for creating awareness and compliance, if a culture of safety does not exist at the front lines of an organization, the lives and well-being of a variety of stakeholders – employees, third parties, and communities – are at serious risk.

Safety leadership at every level: In high-hazard industries, a culture of safety needs to suffuse the entire organization, so that at every level, workers, managers, contractors, and third parties are involved in safety issues.

Proper performance incentives: Performance incentives need to be embedded throughout the organization to focus front line managers as well as higher-level executives on safety issues. Similarly, safety requirements need to be embedded and required in third-party contracts.

Safety culture: A good culture of safety has positive consequences: good employees will be retained and good talent will be attracted.

Case 5 Shareholder lawsuit alleges "culture of lawlessness" at Duke Energy

Company: Duke Energy Corp. (private)
Sector: Utilities
Country: USA

RepRisk Incident: Shareholders sue company following coal ash spill, August 2015

A shareholder's lawsuit against Duke Energy's Board of Directors as well as 21 current and former executives, accuses them of allowing a culture of lawlessness at the company, which resulted in serious environmental violations and USD billions of liabilities. This culture was allegedly supported by the company's influence over the state government and other regulators. The lawsuit accuses the defendants of breaching fiduciary duties, and claims that the Dan River coal ash spill in February 2014 was a direct result of the company's ongoing deliberate negligence. The spill, which was investigated by a Grand Jury, leaked 39,000 tons of coal ash into the Dan River. The lawsuit claims that the company's Board decided to use its influence, rather than take action to comply with the law. North Carolina's Department of Environment and Natural Resources allegedly colluded with the company to block federal cases filed by activist groups, including the Southern Environmental Law Center, over compliance with the US Clean Water Act.

GEC Risk Analysis:

This is an interesting and important legal case in the US because of its nature – a shareholder derivative lawsuit that goes to the very top of a major US-based global energy company, ranked 123rd in the Fortune 500.

Whether this lawsuit succeeds or not, it still provides important lessons and takeaways for the boards of directors and executive teams of companies in general, and also particularly for companies operating in industries that need to have a strong EHS risk management and culture.

Key takeaways and observations:

Culture risk: This case puts culture on trial directly as part of the shareholder derivative lawsuit. While it remains to be seen whether this theory can prevail from a legal standpoint, it is an interesting and important case involving a leading global company where culture risk is being put forward as a possible cause of a serious EHS case.

Leadership risk: The most important lesson from this case, regardless of the final ruling, is that leaders are responsible for the cultures of their organizations.

Responsibility of high-hazard industries: Building on the above point, in the cases of high-hazard industries, both executives and the boards are responsible for infusing the organization with a "safe to speak up" culture that allows EHS concerns and hazards to be discussed without fear of retaliation.

Relationship between the regulator and the regulated: The thin line that often exists (or is crossed) between companies that are heavily regulated and the entities that regulate them, also seems to be on trial in this case. Whether the allegations of this lawsuit are proven, it is clear from this case, as well as others reviewed in this report, that blame may be squarely placed on the government regulators that are deemed to be negligent, have a conflict of interest, or are possibly outright corrupt.

About RepRisk

RepRisk is a leading business intelligence provider, specializing in environmental, social, and governance (ESG) risk analytics and metrics.

Harnessing a proprietary, systematic framework that leverages cutting-edge technology and hands-on human intelligence in 15 languages, RepRisk curates and delivers dynamic risk information for an unlimited universe of companies.

Since 2006, RepRisk has built and continues to grow the most comprehensive ESG risk database that serves as a due diligence, research, and monitoring tool in risk management, compliance, investment management, corporate benchmarking, and supplier risk. The database currently includes risk profiles for over 59,000 public and private companies, 15,000 projects, as well as for every sector and country in the world.

Headquartered in Zurich, Switzerland, RepRisk serves clients worldwide including global banks, insurance providers, investment managers, and corporates, helping them to manage and mitigate ESG and reputational risks in day-to-day business.

RepRisk provides the transparency needed to enable better, more informed decisions. To learn more, please visit www.reprisk.com.

About GEC Risk Advisory

GEC Risk Advisory is a global governance, risk and integrity advisor to boards, executives, investors and advisors, in diverse sectors including financial, pharma, utility, technology, manufacturing, infrastructure, academia and government. Services are both strategic and tactical and include strategic/enterprise risk, reputation risk, cyber-risk governance, ethics and compliance, strategic corporate responsibility, ethical leadership and culture. Our services cover the gamut of these issues because they are all inter-connected and in this age of hyper-transparency and super-connectivity to do otherwise would be to miss the forest for the trees.

GEC Risk Advisory is a different kind of 21st Century global service provider, delivering value without borders, both virtually and in person. The GEC Risk Way is to be constructive, strategic, innovative, customized and nimble for our clients, collaborators and friends alike. We have decades of global corporate executive experience and a deep understanding of - and empathy for - the client perspective, because we were once clients ourselves. Our bottom line is to help our clients *Transform Risk Into Value*.

To learn more, please visit: www.gecrisk.com.

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METHODOLOGY

RepRisk Special Reports are compiled using information from the RepRisk database, which monitors environmental, social, and governance (ESG) risks for companies, projects, sectors, and countries. The RepRisk database currently contains risk incidents on more than 59,000 private and publicly-listed companies. RepRisk analysts monitor the issues related to ESG risk across a broad shareholder and other stakeholder audience of NGOs, academics, media, politicians, regulators and communities. Once the risk incident has been identified with advanced search algorithms and analyzed for its novelty, relevance and severity, risk analysts enter an original summary into the database and link it to the companies and projects in question. No article is entered twice unless it has been escalated to a more influential source, contains a significant development, or has not appeared for the past 6 weeks.

All data is collected and processed through a strictly rule-based methodology. This helps to ensure the balanced and objective rating and weighting of the risk incident, and thus the company's quantitative measure of risk exposure, the RepRisk Index (RRI). The RRI measures the risk to a company's reputation, not its actual reputation.

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