‘Aethical’ corporations: Is there a case to answer under a ‘Social Contract’?

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“... when in every heart the social bond is broken, and the meanest interest brazenly takes hold of the sacred name of “public good,” the general will becomes mute: all men, guided by secret motives, no more give their views as citizens than if the State had never been; and iniquitous decrees directed solely to private interest get passed under the name of laws.”
(Rousseau J. J., 1762, Bk IV, 1)

“... all being equal and independent, no one ought to harm another in his Life, Health, Liberty or Possessions.”
(LOCKE, J. 1690, p.7)

Abstract
The social responsibility (and accountability) of organisations has its philosophical roots in the implied social contract between those empowered by, and those granting power over society’s resources – human, physical, financial, infrastructural and technological. Whether modern corporations can (or should) be held accountable under this contract was debated in accounting literature in the 1980s and 1990s. However, the ‘fundamental’ debate has diminished in recent years, being replaced by analyses, particularly from an organisational legitimacy perspective, of increased social and environmental disclosures.

Current commercial practice focuses heavily on legal obligations and capital market regulations – including regimes requiring social and environmental reporting and ‘good’ corporate governance practices. Corporate behaviour, particularly that of large corporations, has frequently ignored the moral or ethical obligations resting, it is argued, on an underlying social contract – until these are embedded in regulations. This behaviour supports the contention that corporations are inherently ‘aethical’ (amoral) (Clarke and Dean, 2005) and that, therefore, their behaviour depends entirely on the ethical values espoused by directors, senior executives and shareholders. This focus also helps to explain the continuing ‘waves’ of corporate scandals – despite the addition of ‘independent’ directors, ‘audit committees’ and ‘high quality, enforceable’ accounting standards. It also, it is argued, explains the continuing abuses of corporate power despite acknowledgement of ‘stakeholder interests’, and the appeal of ‘organisational legitimacy’ as a motivating factor.

Attempts, largely normative, such as those of Donaldson and Dunfee (1999), in Integrated Social Contract Theory (ISCT), have been made to provide a framework to explain and guide ethical decision-making, draw on ethical ‘hypernorms’ or ‘fundamental’ social values. These, it is claimed, transcend narrower ‘community’ norms and operate in society’s interests across cultural and geographic boundaries. Bishop (2000), while generally supportive of the ISCT approach, raises doubts about the validity of reaching ‘authentic’ norms that will safeguard participants – particularly given the economic power wielded by modern corporations. It is weaknesses such as this that may help to explain apparently unethical/immoral behaviour on behalf of corporations.

In this paper the authors argue that cases, such as James Hardie Industries and its asbestos-related activities, illustrate how corporations use (and abuse) the power vested in them by law to pursue ‘private’ (e.g. shareholder and lender) interests at the expense of the wider society that granted them a mandate to operate and to access society’s resources. However, the increasing social pressures on Hardie which finally resulted in their acknowledgement of a moral and financial obligation to society (and the individuals affected) highlights that legal obligations can be subjugated to social responsibility – under, an implied social contract!
**Introduction**

The major Australian company of James Hardie Industries (Hardie¹), which is now domiciled in The Netherlands is a world leader in fibre cement building products with over 80% of its market in North America. The group has a long and troubled history of asbestos-related activities that resulted in a Special Commission of Inquiry (Jackson Inquiry) established by the government of New South Wales in February 2004. The group’s history has been documented by several authors and is the subject of a number of articles from legal, ethical and organisational perspectives; a summary of the relevant history is provided later in the paper.²

In 2005, Meredith Hellicar, Chairperson of JHI NV, acknowledged that “… we are an interesting and valid case study into the difficulties of putting into action a meaningful and necessary concept of corporate social responsibility in the context of best practice corporate governance that has due regard for the interests of all stakeholders” (Hellicar, 2005).

Does this case add to our understanding of the role of the social contract in underpinning commercial activity? We believe it does and, in particular, that this case demonstrates that ‘aethical’ corporations can be ‘forced’ to recognise the ‘general will’ underlying this contract in determining their (moral) obligations to their ‘community’ – despite contemporary law or practice. In this case the ‘general will’ prevailed, by means of social, political and market actions, over the economic and political power of a large corporate and the protections granted to it by current commercial law and accounting practice.

The Hardie case challenges the more narrowly focussed views of shareholder wealth, stakeholder interest and organisational legitimacy theories in explaining corporate behaviour and as bases for guiding corporate decisions (Mathews, 2004; Bishop, 2000). By effectively ‘forcing’ Hardie into a ‘voluntary’ settlement, public action can be interpreted as confirming that a social contract (or ‘partnership’ – Cragg, 2002) is the ultimate foundation of corporate authority and, hence, accountability and liability in both financial and moral terms. This ties in with the current moves, for example in UK and Australia, to revisit the legal framework of corporate governance regimes which are due, at least in part, to the disparity between recent corporate behaviour and contemporary society’s expectations of ethical conduct.

In addition, the Hardie case raises serious implications for shareholders, directors and officers and professional advisors, as well as for company law and financial reporting regimes. Specifically it raises doubts about the role of the ‘corporate veil’ in quarantining liabilities, the treatment of the claims of ‘future creditors’, and the recognition of moral liabilities and contingencies. There are also related issues surrounding the use of insolvency regulations to avoid liabilities in solvent entities via ‘limited fund’ vehicles.

All of this stems from the creation of the legal ‘person’ devoid of ethical awareness – the modern ‘aethical’ corporation – by grant from society under an implied contract for mutual benefit.

**Background - asbestos**

The serious health consequences associated with asbestos, to employees, installation and demolition contractors and neighbours of mines and manufacturing plants, are well documented internationally (Seib, 2004; Jackson, 2004; Hills, 2005). A particular feature of the resulting medical conditions is the delayed presentation of symptoms – frequently 20 to 40 years after exposure to asbestos dust. Former manufacturers of asbestos products around the world have faced the financial consequences, often long after production and use of asbestos, and its immediate revenue stream, had ceased – although the very existence (and asset base) of these entities stems in large measure from the initial wealth created by asbestos activities. In ‘market’ economies these ‘long-tail’ liabilities³ fall on the manufacturing or distribution entities, their insurers and, ultimately, public health providers and their funders (taxpayers).

Within the asbestos industry, there is a long history of socially irresponsible corporate behaviour. As Spender (2003) states, “… asbestos litigation established that many defendants in the US, Australia and the UK knew at an early stage about the dangers of asbestos and

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¹ As various corporate vehicles and consequent name changes were involved over the years, for this paper the generic short-form of ‘Hardie’ has been adopted except where critical to the discussion (see The Case and Exhibit 1).

² In analysing the actions of the Hardie group, this paper draws heavily on the evidence and findings of the Jackson Commission (Jackson, 2004) and the historical analyses of Haigh (2006).

³ Long-tail liabilities arise many years after the events or transactions which give rise to them.
made a commercial decision to keep producing it, thereby jeopardising lives” (p.235). Asbestos mining, manufacturing and distribution companies had been aware since at least the 1930s of health hazards involving asbestos and, since the 1960s, of specific relationships between exposure to asbestos dust and the incidence of mesothelioma and other cancers. The evidence was undeniable, yet companies continued to manufacture and distribute asbestos-based products – Hardie only ceasing such activities in 1987 (Haigh, 2006). Given the long ‘incubation’ period before these conditions appear, many individuals can be expected to lodge claims from past exposure. Further, in Australia it is estimated that one third of all houses built before 1985 contain asbestos (Briton, 2004), leaving many potential future claimants from deterioration, renovation or demolition exposure – in addition to past and future industrial and community exposures.

The escalation in personal injury claims is indicated by:

- the report that “by 1982 the pace of litigation against (Johns-) Manville had increased to an average filing of three cases per hour, every hour of the business day – The company projected its total asbestos liability at more than (US)$1bn. On 26 August 1982, Manville Corporation filed for reorganisation under Chapter 11 of the US Bankruptcy Code” (Spender, 2003, p. 225);

- In 2000 Owens Corning filed for Chapter 11 Bankruptcy “in an effort to contain its liability for a growing number of asbestos related claims being filed against it. The settlement (in September 2006 for US$5.1bn) is the culmination of the five year legal battle that followed” (Bergman, 2006);

- Turner & Newall (UK) (T&N) is in voluntary administration. T&N was taken over by US company Federal Mogul, which has also filed for Chapter 11 Bankruptcy; and

- Other major companies with asbestos associations, including Cape Asbestos, Halliburton Corporation and, in Australia, CSR (and James Hardie), have also faced and settled escalating numbers and increasing dollar values of personal injury asbestos claims.

Despite evidence of both increasing demands for socially responsible corporate behaviour and the glaringly obvious moral liabilities faced by the companies, the asbestos companies generally attempted to limit their financial exposures to current and future claimants by resorting to reorganising their businesses in order to ‘quarantine’ the asbestos liabilities. The strategies varied slightly, depending largely on their legal jurisdictions – Chapter 11 Bankruptcy (US), voluntary administration (UK) and ‘demerging’ and ‘restructuring’ (Australia). In each case the objective was to protect the company by limiting future liabilities – by ‘disowning’ the asbestos-related entities or by establishing a limited fund against which current and future claims would be directed.

Corporate arguments in support of such moves centre on:

- the legal obligations on directors to act in the interests of shareholders;

- protecting the existence of the company – for the benefit of ‘primary’ stakeholders – for example lenders, employees (including directors and executives), suppliers and customers;

- the ‘golden egg’ concept – that killing the ‘goose’ would cut off the resources available to fund future settlements (Spender, 2003).

However, the behaviour of companies raises serious questions about their intentions regarding their obligations – beyond those to shareholders and corporate lenders. In particular in asbestos cases, the very limited impact ethical considerations have in setting corporate policy is evidenced by strategies such as:

- limiting the funds available to claimants to the amounts deemed ‘marketable’;

- casting adrift asbestos related group entities;

- using insolvency legislation in situations that were not envisaged in their design; and/or

- establishing limited fund vehicles, which will seriously constrain the amounts available for future claimants.

**Social contract(s)**

The concept of a contract between business organisations and society derives from the political philosophy construct of social contract (or compact) between those ‘empowered’ (government)
and the community that grants them that power (by election, abstention or submission) (Locke, 1690; Hume, 1748; Rousseau, 1762a). In the business scenario, corporations are granted rights as ‘legal persons’ under ‘empowering’ legislation enacted by society’s political representatives with the expectation of economic returns to investors, other businesses and society – provided the entities operate within the legal and moral boundaries applying to all ‘citizens’ (Sheehy, 2004-5).

The development of accounting as a social discourse and, in particular, arguments in favour of social and environmental accountability in financial reports, flows largely from the social contract literature (Donaldson, 1982; Mathews, 1984; Gray, Owen & Maunders, 1987). The proposition that organisations are empowered by an implicit contract with society, which in turn leads to an expectation of corporate responsibility and accountability to society was debated in accounting literature in the 1980’s and 1990’s (Mathews, 1997) but since then has received relatively little attention in accounting literature.

In both political and business settings the ‘contract’ is not a formal document, rather an abstraction of the underlying intent. It implies both rights and responsibilities on the part of the state and the people – or the corporation and the society that grants its legislative mandate. In applying the concept to business, Donaldson (1982) asserts that the contract is to serve as the justification for the existence of the corporation and to aid in defining its responsibilities to parties other than itself (as a legal entity) and those to whom it admits being responsible – its (identified) stakeholders.

The benefits to corporations under the social contract include access to society’s economic resources – natural, financial, human, infrastructural and technological – and, very importantly, legal protection for their activities. In return, society expects to benefit from its investment in the entity rather than to incur additional costs in the form of detrimental externalities – such as negative health impacts and/or environmental pollution (Mathews, 1993). Dillard, Brown & Marshall (2005) argue that this access also gives rise to a fiduciary responsibility over the resources accessed. 

It is the benefits to society – for example, increased economic activity and employment – that form the social (as opposed to private wealth creation) justification for the continuing expansion of economic power in the hands of private corporations. Their objectives (as ‘good corporate citizens’) are expected to include the provision of positive benefits and the minimisation of negative impacts for identified stakeholders and society in general. In fact many annual reports do promote just such outcomes in their corporate social responsibility statements.

In a similar vein to Rawls’ (1971 & 2001) discussion of distributive justice and ‘justice as fairness’, Donaldson (1982) points out that the existence of a social contract also requires corporate moral behaviour based on justice:

“… the application of the concept of justice to productive organisations appears to imply that productive organisations avoid deception or fraud, that they show respect for their workers as human beings, and that they avoid any practice that systematically worsens the situation of a given group in society” (original emphasis) (p. 53).

Donaldson continues … that productive organisations are:

“… subject to moral evaluations which transcend the boundaries of the political systems that contain them. The underlying function of all such organisations is to enhance social welfare through satisfying consumer and worker interests, while at the same time remaining within the bounds of justice. When they fail to live up to these expectations they are deserving of moral criticism” (p. 57).

Donaldson’s continuing development of this ‘moral perspective’ of the social contract finds expression in Integrated Social Contract Theory (ISCT). In ISCT it is argued that ‘micro’ social contracts – in community, cultural and geographic contexts – can operate only within “… a hypothetical ‘macro’ social contract that lays down moral boundaries for any social contracting” (Donaldson and Dunfee, 2002, p.1854). These levels of ‘contracts’ are the foundation within ISCT of ethical ‘norms’ and ‘hypernorms’ respectively.

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4 The fiduciary relationship of corporate managers to stakeholders (including the public) was discussed as early as the 1920s (see Dodd 1932).
Alternative theories of business relationships

In *shareholder* (or stockholder) theory, the focus of the company (directors and executives) is on maximising shareholder wealth although there are variations on this. For example, Milton Friedman, in urging that business had a social responsibility to increase profits, acknowledged the constraint of “conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom” (Friedman, 1970, p.138; emphasis added). This basic theory is applied in most accounting techniques, such as capital budgeting and product costing, which traditionally seek to minimise cost and maximise profit, without regard to external (public) or moral (as opposed to legal) dimensions of decisions. Under this theoretical approach it is the government’s role to care for society’s interests – via regulatory processes. This approach also underlies the financial statements – which focus almost exclusively on profit and (financial) capital maintenance.

With the adoption of corporate social responsibility in most capital market economies, it is likely that ‘raw’ shareholder theory is modified in practice, but it is unclear how this is implemented in internal decisions in profit-oriented organisations. The social responsibility requirements are largely a voluntary overlay on the legal focus on shareholder (member) interests.

Under *stakeholder* theories, which assert that the interests of those affected by a firm’s actions must be considered in the organisation’s decision making. While normative theory would hold that all stakeholders should be given ‘fundamental’ consideration, in capital market economies stakeholders other than shareholders are seen as ‘instrumental’ in that they are ‘used’ in pursuit of increased shareholder wealth (Bishop, 2000). Examples of the instrumental view are the inclusion of customer value and supply chain management concepts in current accounting techniques, which are (still) principally aimed at increasing shareholder wealth.

In applying stakeholder theory, however, major issues arise in:

- identifying relevant stakeholders and their specific interests in relation to business activities;
- prioritising conflicting interests for corporate decision making – in a ‘workable’ decision model; and
- meeting the *legal* obligations to members (shareholders) and primary stakeholders (e.g. employees and lenders) while ‘having regard to’ the *moral* obligations to other parties.

If an organisation has obligations (and potential liabilities) that extend beyond those currently recognised in the shareholder and stakeholder-interest versions of current capital market regimes, this has significant implications for company law and external reporting practices.

Under *organisational legitimacy* theory (which is founded on the existence of a social contract), political and economic support from society, as well as from its immediate stakeholders is seen as essential for an organisation to gain and retain access to all necessary resources. Legitimacy is ‘conferred’ on an organisation by external parties based on its behaviour as perceived by its immediate community and wider society (Suchman 1995). However, as ‘legitimacy’ improves an entity’s access to external resources, management may pursue legitimization strategies. Consequently, it is held, an organisation will ‘legitimise’ its activities in response to perceived changes in political and social expectations (Dowling & Pfeffer, 1975; Donaldson, 1982; Lindblom, 1994; Neu, Warsame and Pedwell, 1998; and Milne & Patten, 2002).

A firm may legitimise its actions, as identified by Dowling & Pfeffer (1975), by:

- adapting its operations to conform to societal norms; or, through communications,
- attempting to change society’s expectations – and thereby altering the definition of social legitimacy; or

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5 Only a brief overview is provided of these theories for the purpose of this article.

6 We accept Suchman’s (1995) definition of “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (p.574).

7 Counter arguments to the social contract and organisational legitimacy philosophies and corporate social responsibility proposals were put forward based on alternative political and economic philosophies and the role of accounting information in situations of social conflict (for example Den Uyl, 1984; Tinker, 1984 & 2004; Guthrie & Parker, 1989; Tinker, Lehman & Neimark, 1991). Alternative explanations of corporate disclosure practices within capital market structures are also found in institutional theory: companies conform to accepted institutional practices (Suchman, 1995); and strategic response theory: companies adopt strategies to advocate change in society’s expectations (Sethi, 1977; Oliver 1991).
• improve society’s view of the entity by identifying with symbols, values or institutions that already possess strong social legitimacy (p. 127, adapted).

When viewed as an (intangible) asset that sustains the flow of resources to an organisation, legitimacy, as analysed by Suchman (1995), can be ‘gained’, ‘maintained’ or ‘repaired’ through investment spending on actions such as advocacy (Sethi, 1977), or, as identified by Suchman (1995): “lobbying, advertising, event sponsorship, litigation and scientific research” (p.593), and “restructuring” and “disassociation” (p. 598). In particular, to retain their ‘legitimacy’ companies must, over time, be seen to comply with relevant legislation.

A company’s responses to its perceived social obligations are communicated through its actions (or inaction) and its public statements, in particular in the company’s annual report through its corporate social responsibility content (Mathews 1984\textsuperscript{8}). The annual report may signal a company’s perceptions of its social obligations, but does it reflect their underlying reality – their ‘substance’ in accounting terms? Such realities are frequently driven by current law rather than contemporary social expectations.

**Social contract and company law**

The participation in society of companies, as ‘legal persons’ has expanded over time. Initially, their powers were defined by charter or specific legislation, and actions outside of those powers were *ultra vires* and subject to sanctions. Later, under enabling legislation and company constitutions, greater freedom was granted to pursue commercial goals. Mandated by legislation, these ‘corporate citizens’ have been granted a unique role in society – to create wealth for their shareholders while limiting their personal liability – *without the ‘normal’ social or ethical dimensions of citizenship* (Sheehy, 2004-5). This situation has been compounded in recent decades by the formation of groups of companies and the development of corporate investment vehicles, resulting in multiple layers of *legal personae*, each with limited liability protection.

In recent decades, such companies have been remarkably successful in achieving their commercial goals, as the international economy testifies. Many now operate as ‘global citizens’ – with ‘residence’ in one country but operating beyond the reach of any one nation, sometimes to the concern of national and international agencies. A survey in 2000 revealed that 51 of the world’s 100 largest economic entities were corporations and 49 were countries (Anderson and Cavanagh, 2000) with the impact that “(n)o institution today is so significant in affecting the lives of things on this planet as the corporation” (Association for Integrity in Accounting, 2004, p.5).

The corporation is, of course, incapable of moral judgement or of being influenced by ethical codes of conduct. It is entirely governed by law with, arguably, its directors constrained to observe this same limitation – in their capacity as its ‘governors’ acting in the interests of the company. Directors may, of course, be motivated by personal ethical values, yet feel obliged to act within what they perceive to be the legal constraints on the ‘ethical’ corporation. Further, directors are, of course, the representatives of shareholders (increasingly other companies), hence shareholders can be seen to endorse their companies’ actions – by re-electing directors or simply by remaining as members and accepting the rewards of ‘ethical’ investment.

This situation is described by 4-5(2006) as “the corporation, this artificial being, created with the sole motive … of profit, (that) changed fundamentally the ethics of socio-economic interactions, and hence the ethics of business” (p.24). Dunfee (1996) also noted that “law without reference to ethics and community moral values is in danger of becoming disconnected from the public will” (p.319).

This view of corporate ‘amorality’ is also reflected in the comment by Clarke (2004), that as “a creation merely of the law, a company has neither a conscience nor a soul. As such it has been an object of concern for many social scientists for decades” (para. 3). Clarke and Dean (2005) cite Berle and Means’ (1932) concern for the agency problems associated with the separation of ownership and control and their assessment that large public companies were the *dominant institution in the modern world*, as (with hindsight) “a warning that the modern corporation would become ungovernable” (Clarke and Dean p.21, *original emphasis*).

\textsuperscript{8} Mathews regularly monitored social responsibility reporting and reviewed the academic debate in this area in general, for example Mathews, 1985; 1993; 1997; 2000; & 2004. (See also: Gray, Owen & Maunders, 1987; Gray, Owen & Adams (1996))
Over time it became apparent that corporations needed to be ‘reigned in’ from pursuing purely ‘wealth creation’ objectives if human ‘values’ in society were to be protected. As noted earlier, even Friedman acknowledged the constraint, in pursuing profits, of "conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom" (Friedman, 1970, p.138).

Despite significant advances in reporting of corporate social responsibilities (Jones, Frost, Loftus & van der Laan, 2005), company law generally still fails to reflect society’s concerns over lack of accountability of major corporate groups. Limited liability protection and the corporate veil can be used to prevent access to group assets beyond those vested in the ‘offending’ company. These devices have been defended as promoting entrepreneurship and encouraging economic growth. However, they were enshrined in company law and precedent long before modern group structures evolved, with the intention of protecting ‘human’ investors from attacks on their personal assets in ‘normal’ business dealings. Their use today of shielding artificial ‘persons’, their share price, and their directors, officers and shareholders from the direct consequences of past business activities is a corollary not foreseen by the original designers of the corporate vehicle. Additional concerns in company law in such cases, include the difficulties faced in attempting to pursue multinational corporations for recovery of overseas assets. Such issues are the subjects of continuing debate in several jurisdictions.9

While several countries have passed legislation to recognise broader stakeholder interests (particularly employee and environmental protection) the behaviour of many major corporates continues to pursue shareholder interests almost exclusively. This is indicated in the US, where a number of States have passed broader stakeholder legislation, but “in Delaware (where 50 per cent of US public companies and more than 60 per cent of the fortune 500 companies are incorporated) directors are still required to owe an ‘unyielding’ duty to the corporation and its shareholders” (Standen, 2005).

Elements of the underlying social contract with business have been implemented through increased laws, regulations and formal codes in attempts to moderate the actions of companies (and regulate the manner in which they account for their actions). Acceptable (‘legitimate’ – ISCT) norms, while varying from culture to culture (and over time), usually encompass basic values that ensure minimal harm is done to society in general, to individuals and to the environment. Examples of ‘values’ derived from the social contract that have been encapsulated in legislation in many countries are: child protection, occupational safety and health, employment relations and environmental protection or remediation. In the face of the sanctions imposed by such legislation and/or the resulting adverse publicity, companies generally abide by the codified requirements. However, society’s values change over time with laws and other formal value statements inevitably lagging behind, leaving scope for companies to push the boundaries of society’s expectations – and its approval (positive support) or tolerance (passive support).

**Evidence of ‘market’ and corporate responses**

By the 1990’s changing expectations of society in relation to corporate social behaviour were emerging. Examples included:

- employment practices, workplace health and safety and environmental protection legislation had all followed social pressure on companies and governments;
- the tobacco industry and sections of the chemicals and pharmaceuticals industries were confronting social protests and class action suits;
- individual companies pursuing ethically ‘unacceptable’ policies, such as Nike (child labour) (Hess, 2001), Shell (in Nigerian political and environmental disasters) (Donaldson and Dunfee, 1999, pp.1-5), and several multinational companies involved in bribery scandals, all issued public apologies and adopted, at least publicly, more socially responsible practices;
- investor groups promoting ‘ethical investment’ initiatives were successfully lobbying the capital markets to develop ‘screened’ investment funds; and

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9 See, for example, the concerns outlined in Research Note no. 12 2004-05, Parliamentary Library, Australia (Prince, Davidson & Dudley, 2004).
corporate social responsibility accounting, and ‘triple bottom line’ reporting were apparently making headway.

In more recent years, political, media and market reactions to major corporate scandals demanded tighter securities and corporate governance regulations, including increased ethical behaviour by corporations, their ‘governors’ (directors and officers) and their auditors (Clarke & Dean, 2005). This is evidenced in revised regulatory standards – under various laws and codes in many countries, such as the Sarbanes Oxley Act (SOX) (2002) in the US and CLERP 9 in Australia. Many stock exchanges introduced more stringent governance and reporting requirements and in other jurisdictions, like New Zealand, the ‘regulator’ issued more extensive guidelines for corporate governance, including board integrity and responsibilities for risk management, corporate reporting and independent audit (New Zealand Securities Commission, 2004). In many cases these changes reflect attempts to improve ethical behaviour – by directors and senior management who shape corporate behaviour and reporting, and by their auditors in a perceived role as ‘corporate watchdog’.

In Australia, reports have been commissioned from Government advisory panels on corporate social responsibility, strengthened protection for long-tail personal injury claims, and weaknesses in corporate law – including the use of limited liability protection (‘corporate veil’) within groups of companies. These reviews are largely in response to concerns, expressed through media reports, public protest actions, and political and judicial inquiries, arising from a number of “newsworthy maladministration, misbehaviour and collapses by a few high-profile corporations” (Horrigan, 2005).

A notable current response to the changing expectations (norms) of society in the UK is the Companies Bill (HL) (2006), which is before the House of Lords. This proposed legislation states the overriding duty of directors as “to promote the success of the company for the benefit of the members as a whole”, but specifies “having regard to” the long term consequences of their decisions and explicitly taking account of the interests of employees, suppliers, customers, and others with business relationships, and the “impact of the company’s operations on the community and the environment” (Sec 173 – see Exhibit 2).

Such reactions are likely to result in additional regulation of corporate activities – by government agencies, stock exchanges and accounting standard setters. Whether more ‘rules’ will improve participants’ behaviour in the interests of society rather than in the specific interests of their shareholders and possibly the ‘inner circle’ of (primary) stakeholders, is doubtful (Horrigan, 2005). Focusing Board and managerial attention on ethical issues as opposed to (short term) shareholder wealth creation is also doubtful. As highlighted by Clarke and Dean (2005), the existing problems in corporate and management behaviour stem largely from non-compliance with current regimes requiring ethical, independent and principled governance – even in the absence of fraudulent activities.

Published corporate statements and governance reports now reflect broader risk analyses, some incorporating social and environmental externalities as “moral liabilities” (Gettler, 2005). Such reports, which cover much more than financial controls and statements, would appear to be a response to the existence of a deeper underlying social responsibility (or social contract). However, these regimes still “involve no or very little overt and explicit consideration of what is or is not ethical” (Boden, 2005, p.76). Boden’s analysis of events involving Sainsbury’s (a large UK supermarket operator) employment practices and of pharmaceutical companies’ HIV/AIDS drug pricing policies, had the objective of “interrogat(ing) the concept of corporate governance as it relates to ethical, socially responsible behaviour” (p.74). Reflecting on Hardie’s corporate behaviour in another jurisdiction and another industry may also advance this effort.

Companies’ responses to their social obligations vary widely – influenced by their cultural and legal contexts as well as the ethical standards of their ‘governors’. International responses to long-tail asbestos liabilities range from denial (and prolonged court battles), through ‘legal’ remedies such as restructuring, voluntary bankruptcy or administration, to financial provisioning of anticipated settlements – by corporates and their insurers (See Cooper, 2002; Insurance Information Institute, 2005). All of these responses evidence the existence of major potential liabilities – whether or not they are recognised under current accounting frameworks and practices.

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Accounting practices, in relation to such corporate responsibilities, are conventionally limited to situations that are legally enforceable between the parties. In other words, ethical social obligations virtually never motivate accounting practice. As expressed by Clarke (2004):

“Clearly companies have not measured up to public expectations, notwithstanding that they have satisfied the perceived canons of good governance” (para. 4).

Disclosures in corporate annual reports in relation to social/environmental impacts may reflect: legal or professional reporting requirements, revised corporate governance regimes, institutional pressures, or individual company’s ‘legitimisation’ or ‘advocacy’ strategies. Corporate behaviour, however, may or may not be reflected in these disclosures, and both the behaviour and reporting practices may well lag behind society’s expectations.

Examining instances of corporate behaviour – such as in the case of James Hardie Industries – should continue to shed light on such issues as:

- the existence of the social contract in business settings;
- whether a social contract can be invoked to extend (or override) legal obligations;
- the validity of alternative theories of corporate responsibilities and behaviours;
- the effectiveness of ‘transparent’ reporting practices required under governance regimes; and
- the adequacy of current accounting practices in reporting corporate ‘moral liabilities’.

The Case – James Hardie Industries

Originally founded in Australia in the 19th century, Hardie developed into a major Australian company and the world leader in fibre cement building products. From early in the 20th century, the company was involved in asbestos mining, and importing and manufacturing asbestos-based products until – 1987 when it ceased asbestos activities. In recent years, the group has been a leader in the development of non-asbestos fibro-cement building products and operates principally in the US, Australia, New Zealand, the Philippines and Chile. The group, now under a holding company domiciled in The Netherlands [James Hardie Industries NV (JHI NV)], has a market capitalisation of c. $US3.5bn and 3,300 employees. (JHI NV Annual Report 2006.)

The first workers’ compensation claim against Hardie for asbestosis (as it was then known) was in 1939 (Hills, 2005; Haigh, 2006). By the mid 1960s Hardie had medical evidence of asbestos-related diseases in its employees and the company was alerted as early as 1967 that their liabilities might be “as much as A$1.5 million” – against shareholders’ funds of A$30 million (Haigh, 2006, p.99). Yet even in the 1970s their plants were as described by visiting Health Department medical staff as “not remotely as they should have been” (Haigh, 2006, p.112). While the early claims were limited to employees directly involved in the mining and manufacturing processes, installers and users of asbestos products had also been diagnosed with attributable medical conditions and joined the queue of claimants for compensation.

Hardie’s initial reaction was largely denial, as highlighted by Hills (2005):

“Evidence dragged from the company’s files during the past two decades of litigation show quite conclusively that the company ignored its obligations to protect the health of its workers, its consumers, and the environment” (p. 213).

Faced with a rising tide of claims from many years of asbestos related activities, Hardie, like other companies in the asbestos industry, sought both industrial solutions and legal approaches to limit the financial impact on the group. Within the Australian industry, however, Hardie was notable for its consistently ‘hard line’ in denying liability and forcing compensation claimants through protracted legal hearings (Haigh, 2006).

Corporate restructuring

Against the international background of increasing demands for corporate social responsibility and rapidly escalating asbestos settlements, during the 1990s the Hardie group restructured to isolate its profitable trading operations from asbestos compensation liabilities. In 1997 Hardie developed what was termed “Project Chelsea” in order to:

- separate its core assets and operations and ‘quarantine’ its former asbestos companies and their long-tail liabilities;

• relocate the residence of the operating group to The Netherlands – to reduce the taxation impacts of its predominantly US business through international tax agreements; and
• to launch an initial public offering (IPO) of shares on the New York Stock Exchange.

This proposal required the parent company (JHIL) to transfer the operating assets to a new subsidiary company (JHNV), in exchange for shares in JHNV with JHIL holding only non-core assets and the shares in its asbestos-linked subsidiaries. The Hardie board were satisfied that the ‘corporate veil’ doctrine would prevent any claimants successfully pursuing JHNV if funds in the asbestos subsidiaries proved insufficient. When discussions with its US advisors indicated that the IPO was unlikely to succeed for a number of reasons, including the asbestos liabilities, the board sought “alternative strategies to fund the company’s future – and predominantly overseas – growth” (Hellicar, 2005, p.2).

By 2000, a revised proposal (‘Project Green’) had superseded Chelsea. Experience in negotiating overseas restructuring deals had proved that the asbestos liabilities were a serious deterrent in any equity scheme. Where “Chelsea had been aimed merely at shutting the door on asbestos; Green was imagined as locking the door and throwing the key away” (Haigh 2006, p.205). Project Green involved vesting the shares in the JHIL asbestos subsidiaries (now Amaca and Amaba) with sufficient assets to cover the estimated asbestos liabilities, in a group-owned ‘foundation’ with no right of recourse to the continuing group. Effectively this was a proposal to establish a limited fund trust, relying on the corporate veil and limited liability to isolate the operating group from future asbestos claims in excess of the initial fund. However, in the face of the rapidly escalating value of claims, and after considering the likely public reaction to an ‘internal foundation’, the Hardie board announced a major restructure (Haigh 2006).

In February 2001 JHIL issued a press release that announced it “had established an independent Medical Research and Compensation Foundation Ltd (MRCF) to compensate sufferers of asbestos related diseases with claims against two former James Hardie subsidiaries and fund medical research aimed at finding cures for these diseases”. MRCF was to be independent of JHIL and “its establishment has effectively resolved James Hardie’s asbestos liability and this will allow management to focus entirely on growing the company for the benefit of all shareholders.” The release also assured “the Foundation has sufficient funds (A$293m) to meet all legitimate compensation claims anticipated …” “JHIL CEO Mr Peter Macdonald said that the establishment of a fully funded Foundation provided certainty for both claimants and shareholders.” … “When all future claims have been concluded, surplus funds will be used to support further scientific and medical research on lung diseases” (JHIL 2001, emphases added).

MRCF was granted ownership of Amaca and Amaba with net assets estimated at AUS$293m – including amounts due by JHIL, but with no recourse to JHIL once those assets were exhausted. Hellicar (2005) notes that MRCF was provided with more funds (A$293) than the minimum required to cover the estimated liabilities. As established by the Jackson Inquiry, this funding was based on outdated actuarial assessments of A$273m, made without access to Hardies’ 2000 claims record. In evidence presented to the Inquiry, “KPMG’s independent recalculation of the liabilities (was) $694 million, rising when including the (2000) data to $1044m” (Haigh 2006, p.241).

Later in 2001, using a new holding company, James Hardie Industries NV (JHI NV), the Group relocated its corporate domicile to the Netherlands with which Australia has no civil enforcement agreement. Approval under a scheme of arrangement for the restructure and relocation was granted on 11 October 2001 (in the Supreme Court of New South Wales). Assurances given by JHIL that sufficient assets were available in Australia to meet any liability for future compensation claims were backed by partially paid shares in JHIL held by JHIL NV which JHIL, it was stated, would be able to call up to obtain further funds if required. These shares were subsequently cancelled without public notification when JHIL (now ABN60 Pty Ltd) was vested in a new foundation ABN60 Foundation which would meet the calls from MRCF up to the amount due under its agreement (covenant and indemnities) with JHI NV. This arrangement was in response to extreme reluctance by the directors of MRCF to accept a transfer of ABN60

12 “JHIL will have, through existing reserves and access to funding in the form of the partly paid shares, the means to meet liabilities which will or may arise in the future ….” Written response to Santow, J. by JHIL counsel, in Haigh, 2006 p288 footnote.
Pty Ltd to MRCF in a 'full and final' settlement. It effectively also put a further ‘veil’ between JHI NV and the asbestos claimants.\textsuperscript{13}

The extent of the underfunding of MRCF was soon clear. In July 2001, less than six months after its formation, and before Hardies had obtained Court approval to relocate to The Netherlands, the directors of MRCF were deeply concerned about the underfunding and were contemplating liquidating Amaba (Haigh, 2006, p.293). Eventually, in 2003 the directors of MRCF publicly announced that the Foundation would exhaust its funds by 2007 – with at least a further 40 years of claims to be met.

Media\textsuperscript{14} and union action also resulted in the threat of customer boycotts throughout Australia, the US (where the company now does 80% of its business), and Canada (Alderton, 2005). Several Australian State Governments also threatened to ban Hardie products under supply contracts and, at a local level, “James Hardie has admitted that council boycotts are starting to bite into its profits” (Buffini 2004). The government of New South Wales also threatened to pass retrospective legislation to force Hardie to compensate victims.

This public outcry resulted in the formation of the Jackson Inquiry in early 2004 by the Government of New South Wales, which reported in September 2004.

\textit{The Commission}\textsuperscript{15}

The terms of reference of the Special Commission of Inquiry into the MRCF covered:

(i) the financial position of the MRCF with respect to its future asbestos-related liabilities;

(ii) the circumstances of the separation of MRCF from the James Hardie Group;

(iii) the impact of the corporate restructuring on the ability of MRCF to meet its current and future asbestos-related liabilities; and

(iv) the adequacy of current arrangements under the Corporations Act to assist MRCF to manage its liabilities and whether reform is desirable to those arrangements.

The Commission’s hearings revealed and documented evidence of Hardie’s failure to fund the Foundation on reliable actuarial estimates of liability, of making misleading public statements, and deliberately avoiding its moral obligations. In examining individual events (taking a ‘transaction by transaction’ approach rather than an overview of corporate strategy), the Commission held that the company had acted generally within the law.

The Commission’s deliberations were partially overtaken (at the very end) by JHI NV accepting that “the Foundation (MRCF) had been underfunded, and to a very significant degree” (Jackson (2004) Sec 1.22) and the Group also indicating that it was prepared to fund the future asbestos-related liabilities of MRCF arising from the JHIL companies (Sec 1.23).

Despite these events pre-empting a full finding on the initial adequacy of the funding of MRCF, the Commissioner expressed serious concerns, including:

- That while “there was no legal obligation for JHIL to provide greater funding to the Foundation (MRCF), JHIL was … very aware … that if it were perceived as not having made adequate provision … there would be a wave of adverse public opinion which might result in action being taken by the Commonwealth or State governments (on whom much of the cost of such asbestos victims would be thrown) … to legislate to make other companies in the Group liable …” (Jackson (2004) Sec 1.8).

- “The notion that the holding company would make the cheapest provision it thought ‘marketable’ in respect of those liabilities so that it could go off to pursue other more lucrative interests insulated from those liabilities is singularly unattractive. Why should victims and the public bear the cost not provided for?” (Jackson (2004) Sec 1.25).

\textsuperscript{13} It must be stressed that none of these restructuring ‘manoeuvrings’ are illegal – indeed Hardie was driven by what they perceived as their legal duty to shareholders.

\textsuperscript{14} Media coverage commencing in the late 1960s increased following an ABC TV ‘Four Corners’ programme in 1989. Following Hardie’s launch of the MRCF and relocation to The Netherlands, only a few commentators (for example Hills) followed the story. The financial press was “docile and tractable … and other public guardians were largely inert” (Haigh, 2006 p. 277). By late 2002 national media coverage was escalating focussed on the plight of victims and the ‘scandal’ of Hardie’s responses. This pressure combined with union and political activity until, in February 2004, Carr announced the formation of a Special Commission of Inquiry.

\textsuperscript{15} Summarised from Jackson (2004).
• “The circumstances have raised in a pointed way the question concerning whether existing
laws concerning the operation of limited liability or the ‘corporate veil’ within corporate
groups adequately reflected contemporary public expectations and standards.” (Jackson,
2004, Sec 30.67).

On 1 December 2005, JHI NV signed a 'Final Agreement' with the NSW State Government
under which JHI NV would provide further funds to enable MRCF to meet future asbestos
compensation claims. The value of current claims was estimated at 30 June 2005 as AU$1.6
billion and is estimated to reach $A4.5bn over 40 years (Slater & Gordon, 2005). The Final
Agreement is subject to conditions that, at 31 July 2006, have not been satisfied – including tax
deductibility of the funding payments.

During this lengthy period, Hardie’s directors maintained publicly that the company had
discharged all its obligations – legal and social. As stated in JHI NV’s 2004 Annual Report:

“While it is difficult to predict the incidence or outcome of future litigation, the Company
believes it is remote that any significant personal injury suits for damages in connection
with the former manufacture or sale of asbestos containing products that are or may be
filed against ABN 60 (formerly JHIL) or its former subsidiaries would have a material
adverse effect on the Company’s business, results of operations or financial condition.
This belief is based in part on the separateness of corporate entities under Australian
law, the limited circumstances where “piercing the corporate veil” might occur under
Australian law, and there being no equivalent under Australian law, of the US legal
document of “successor liability” (p.86, emphasis added).

The Commission’s conclusions clearly indicate that this perspective of the company’s
obligations would not have been supported. Even within its narrow terms of reference, the
Commission accepted that there were underlying social and ethical obligations that the
company had disregarded, and this case had potentially brought the adequacy of society’s
protection from corporate abuses under scrutiny – at least in Australia.

Case analysis

Social contract

Over many years, Hardie attempted to avoid any responsibility for the adverse results of its
asbestos related policies and practices – beyond reluctant settlement of a small number of
employee claims. Their avoidance behaviour relating to social (moral) obligations arising from
their asbestos-related operations continued until 2005.

There can be no doubt that, over several decades, Hardie has provided significant economic benefits to its
shareholders, employees and local community, through wealth creation and distribution. It has also
contributed to the national economies in which it operates. There is also little doubt that Hardie, in relation
to the asbestos-related events reviewed by the Jackson Inquiry, generally acted within the law and
complied with contemporary accounting and accountability practices. However, the ‘rebellion’ of asbestos
disease victims, their representatives, the directors of MRCF, politicians, the community and international
market forces against Hardie’s breaches of acceptable standards of corporate social behaviour provides
strong evidence of the existence and public enforceability of an underlying social contract. Such
concerted action, is reminiscent of the views of Locke and Rousseau that the social contract
was “a means to justify the overthrow of tyrannical rules” (Sheehy, 2004-5).

While over time, societal norms and values change and organisations may be slow to adapt to
the changes, the expectation that individuals have a right to protection of their health and life,
from the actions of others, has been embedded in social consciousness for centuries. As
summarised by Locke (1690):

"all being equal and independent, no one ought to harm another in his Life, Health, Liberty
or possession” (p.7, emphasis added).

In what can be seen, at best, as ‘aethical’ actions, for many years Hardie failed to give serious
attention to working conditions and paid scant regard to customers’ exposure and community
health concerns. Further, long after many international companies had conceded the need to
meet the growing tide of asbestos-related claims (often through restructuring or class action
settlements), Hardie continued to fight individual court battles and ignore increasing public
discontent, which gathered momentum from the mid 1960s (Haigh, 2006).
Facing a rapidly increasing value of long-tail claims, between 1995 and 2001 Hardie attempted to minimise the potential financial liabilities resulting from its social (health) obligations by a series of restructuring schemes, including ‘isolating’ the former asbestos-linked companies, establishing the MRCF and relocating its corporate domicile to The Netherlands. These strategies also attempted to position the group for a listing on the New York Stock Exchange, which necessitated eliminating the asbestos ‘heritage’, and to take advantage of international tax treaties.

The principal focus of all of this was the return for shareholders – not the interest of other stakeholders, particularly those in the ‘outer circle’. There is, of course, the argument that the continued growth of the company was the best security for future claimants – the goose that lays the golden egg scenario (Spender, 2003). This was alluded to by Hellicar, 2005) when she stated: “(i)t is the group’s very success that will enable it, with the support of its shareholders and lenders, to provide compensation for claimants so far beyond its legal liabilities” (p. 7).

However, all Hardies’ initial attempts (from the late 1990s until mid 2004) to quarantine the claims and establish a limited fund, were designed to restrict access to the rewards from future “success” of the group.

As is now well documented (Jackson 2004; Hills 2005), Hardie’s manoeuvring left only very limited funds in the hands of the MRCF to meet future health claims. However, despite (i) seriously underfunding the MRCF, (ii) resorting to complex corporate structures to isolate the parent company from future long-tail claims (Jackson, 2004) and (iii) shifting its legal domicile to the Netherlands, Hardie maintained that it had discharged all its obligations – legal and social.

Of significance is the timing of the ‘disclaimer statement’ in the Annual Report (2004) quoted earlier – which was made towards the end of the Jackson Inquiry – that it is “… remote that any significant personal injury suits … would have a material adverse effect on the … Company’s … results”(p. 86). The directors (and their legal and financial advisors and auditors) may well have been attempting to protect the company’s position, but the statement could hardly be said to ‘fairly represent’ the underlying position that, less than four months later, saw the company ‘voluntarily’ offer in excess of A$1 billion in additional funding to settle future claims.

Even during the course of the Inquiry it became apparent that the directors, senior executives and advisors had known otherwise (Haigh, 2006). With the benefit of (very short) hindsight it would be evident that the financial impact of their moral obligations was not remote and should have outweighed the legal (and accounting?) interpretations of ‘contingent liabilities’.

Using their reasoning, Hardie adhered to the ‘rules’ (norms) of the business community in which it existed – laws, regulations, accounting standards and legal precedents. In addition, in their annual reports, Hardie promoted their corporate governance regime complete with “high standards of ethical behaviour” and a “Code of Ethics” (JHI NV 2004, p.62 and 2005, p.90). In this regard, Clarke 2004 states:

“It is sobering to note that James Hardie received four and a half (of five) stars in a recent governance tick-a-box rating exercise. James Hardie also received “gold” in the 2004 Annual Report Awards, notwithstanding the criteria being supportive of the triple bottom line notion, which is supposed to capture social awareness”. (para. 4)

While meeting what the directors and their professional advisors saw as their obligations to shareholders and the capital markets, Hardie has been shown to have behaved in anything but an ethical manner towards its employees, customers, users and the wider community in relation to decades of asbestos-related activities. This has been demonstrated through its corporate restructuring, relocation and funding practices (Jackson 2004).

In particular it can be argued that Hardie did not observe the implied social contract in that it did not adhere to the:

- societal norms and values (or Donaldson and Dunfee’s (1999) “hynernorms”) expected of it; and/or
- wider concept of justice put forward by Donaldson (1982) and show respect for … workers as human beings, [or] … avoid any practice that systematically worsens the situation of a given group in society (adapted, p.53).

This is not a case of short-term oversight, but of long-term strategy, as the entity had actively breached the underlying working conditions over many decades and, at the same time, made
settlements, mostly “out-of-court … with secrecy clauses” (Hills, 2005, p.213) to claimants who fronted up to the company. Based on interviews with Hardie staff and external parties, and extensive analysis of documentary material, Haigh (2006) traces the development of Hardie’s strategies and responses to increasing (internal and external) concern over settlement costs and ethical obligations.

Hardie’s actions over many years can be seen through several behavioural theory ‘lenses’. Some of their responses may be summarised as follows:

- **Under shareholder theory**, shareholder wealth maximisation is the dominant objective of the firm. Haigh’s (2006) analysis of company policy and boardroom and executive communications highlights that short-term legal obligations to shareholders dominated their thinking and actions. Examples include the strategies of ‘denial’ of responsibility, ‘structural separation’ of the former asbestos companies, ‘corporate relocation’ to The Netherlands, and the ‘minimal legal funding’ of the foundation (MRCF). According to Haigh (2006), this (shareholder) view was particularly strongly held by Hardie’s senior executives and the board representatives of institutional investors (for example, pp. 235-6).

  Haigh (2006) also cites one Hardie director as recalling (of the MRCF funding discussion):
  
  “… in my mind it is always the long-term interests of shareholders that matter. And the long-term interests … were not served by doing something of this kind” (p.237).

  These ‘shareholder’ views focusing on financial performance and share price, dominated board decisions, while the company’s social responsibilities – legal and ethical – were entirely subordinated or ignored.

  The capital market was apparently persuaded by Hardie’s asbestos strategies, at least as evidenced by the Hardie share price which rose from $2.70 in 1998 to a peak of $7.70 in October 2003. Hardie’s share price, which “outperform(ed) the broader market for two years (2002-03)” (Hill, 2004), appears to have been largely unaffected by anything other than the company’s legal and professional obligations and reported profit performance. The serious long-term breaches of the social contract in relation to health and environmental issues and the corporate structure manoeuvring apparently made no impact on the market – until the vociferous public disclosures, the announcement of a Special Inquiry, the exposure of extensive potential liabilities and threats of customer boycotts impacted on profit expectations.

- **From a ‘stakeholder interests’ perspective**, Hardie’s focus was on meeting only those interests clearly identified – ‘fundamentally’ those of shareholders and capital markets, and ‘instrumentally’ product markets, regulators, and (eventually) employees’ health and safety, and specific worker’s compensation claims. Stakeholder theory could have been implemented (for example, using ISCT ‘guidelines’). However, the interests of groups with no specific ‘voice’ or legal standing – such as customers’ employees, neighbours and unidentified potential claimants – were almost totally ignored, if not actively dismissed. Hardie clearly did not seriously contemplate the interests of stakeholders beyond those seen as directly impacting on immediate profitability – exposing a significant limitation of ‘stakeholder theory’ in explaining corporate decisions and behaviour (Bishop 2000).

- **From an ‘organisational legitimacy’ perspective**, relatively few of Hardie’s actions on asbestos can be seen as ‘legitimising’, in relation to society’s expectations. With the notable exception of attempting to establish a foundation (the cheapest ‘marketable’) (Jackson, 2004, Sect.1.25), Hardie stuck extremely closely to the ‘legal liability’ argument and was focussed almost exclusively on shareholder interests. Despite rising international concerns over the dangers of asbestos, the company ignored warnings of serious dust conditions, played ‘hard ball’ over individual claims, was extremely reluctant to negotiate a funding settlement and then seriously underfunded its ‘voluntary’ foundation. Its eventual response to social pressures only came once it was under political and market threats to its business activity – in Australia and the US.

  Where it did reflect ‘legitimisation’ strategies was in public statements, such as “the establishment of a fully funded foundation (that) provided certainty for both claimants and shareholders” (Haigh 2006, p.263). By emphasising the ‘voluntary’ nature of their action, highlighting the (intended) ‘research’ capacity of the fund, and that it was ‘fully funded’ Hardie certainly attempted to gain public approval for the company’s future activities and
protection for its markets. However, when seen as part of a ‘quarantining’ strategy for asbestos liabilities – rather than a ‘gain’ for future cancer sufferers – this move can be seen as a cynical attempt at manipulation. Further, the claim of ‘voluntary’ action (Hellicar, 2005) is only by contrast with legal compulsion – the step was taken under extreme pressure on Hardie and the entire asbestos industry.

Patel and Xavier (2005) examined the Hardie case using Suchman’s (1995) matrix of legitimacy strategies: the ‘pragmatic’, ‘cognitive’ and ‘moral’ types of legitimacy, and the ‘gain’, ‘maintain’ and ‘repair’ phases of legitimacy management. They concluded that Hardie had focused their efforts on ‘repair’ and ‘(re)gain’ phases, and on ‘pragmatic’ and ‘cognitive’ types of legitimacy. They particularly noted that “… very few moral legitimacy strategies were used. This presents an interesting juxtaposition as much of the debate from stakeholders to the organisation related to moral legitimacy” (p.12).

- Using Oliver’s (1991) categories of strategic responses to institutional processes, Hardies actions in relation to asbestos claimants can be readily classified as ‘avoidance’, ‘defiance’ and ‘manipulation’ (See O’Connell & Webb, 2006) in relation to Hardie’s actions post 2001 with the setting up of the Medical Research and Compensation Foundation. These responses increasingly move along the passive – active spectrum, and indicate that Hardies adopted increasingly active strategies to isolate its business from perceived threats to its pursuit of wealth maximisation.

- From a social contract perspective, the Final Agreement resulted from the ‘general will’ (Rousseau, 1762b) of society – expressed in outrage at the abuse of the powers entrusted to the company under existing legal mandates and professional codes. This ‘will’ was mobilised by victims groups and the media. Their activities resulted in customer boycotts and were finally given effective ‘voice’ by the Government of New South Wales with the formation of the Commission of Inquiry.

While these theories all offer a partial explanation of certain Hardie actions, in the authors’ opinion social contract theory best fits the outcome in the Hardie case. Under legitimacy theory, the board could have been expected to take authentic legitimising action significantly earlier and in a much less defiant manner in order to obtain the ‘approval’ of society – to protect its future business opportunities. There was no apparent evidence of the concern for the fundamental personal welfare of the victims of many years of profit generation through asbestos operations. The voluntary legitimising actions were minor, with the major change, to acknowledge on-going funding for future claimants, being effectively demanded by overt legal and social pressures. Hardie only responded when it became evident that legal sanctions were very likely follow. Thus the social contract that underlies and mandates the legal framework appears to provide the best explanation of the company’s actions in this case.

Strategic response analysis (seen as an institutional process) describes but does not explain many of the company’s responses. Classical shareholder wealth maximisation theory explains the observed behaviour – but only from a short-term perspective driven by immediate share price concerns, and does not take account of the moral dimension of business decisions – until the moral override of the social contract intervened.

Company law and accountability
Factoring responsibility for past actions that result in long-tail liabilities and moral obligations into corporate decisions poses difficulties for directors under current corporate law in Australia (and most other capital market economies). Hellicar (2005) is undoubtedly correct when she asserts, of corporate social responsibility, that “saying … is the easy part; doing would be easy too, if shareholders, directors, the courts, layers and the community at large all held the same view on social and environmental concerns”; she continues: “doing, however, is part of a director’s duty…” (p.2). It is the duty of directors to balance these ‘views’ in order to implement a responsible policy with care and diligence, and to make appropriate recommendations to shareholders.
Across the asbestos industry, corporate responses have included: acknowledging responsibility by settling individual and joint claims; providing for estimated financial impacts and noting contingent and potential (unquantifiable) liabilities; establishing limited fund trusts; demerging and quarantining asbestos related group companies; using insolvency procedures to limit future settlements, particularly in class actions (Spender, 2003). The outcome in the Hardie case effectively establishes that there were quantifiable financial liabilities attaching to ethical obligations in the situation of long-tail personal injury liabilities, which were inappropriately ‘balanced’ by the directors. This, we argue, raises serious issues for ‘good’ corporate regimes in all major corporates: to ensure that they are appropriately responsive to developing societal expectations.

Further, Hardie’s assurances in their Annual Reports regarding their corporate governance practices and their “Code of Ethics” call into question the effectiveness of corporate governance regimes in influencing the ethical behaviour of directors and executives. The lack of congruence between these claims and the observed behaviour in this area also raises serious questions about the validity of management representations and accountability – particularly in the absence of audit standards.

Should a contingent liability have been disclosed in the consolidated financial statements of JHI NV? Not under Australian equivalents to International Accounting Standards (AIAS) as the liability attached to entities legally outside the group, with JHI NV ostensibly protected by the corporate veil. However, the ethical/moral/social and ultimately financial liability arose from past events (actions or inactions) by JHI with demonstrably measurable outcomes. This resulted in a recommendation that Hardie’s institutional investors not accept the 2004 Annual Report. Corporate Governance International advised its “blue ribbon clients to abstain from voting or reject the accounts because they do not allow for potentially billions of dollars in asbestos disease liabilities” (Higgins, 2004). That such advice was necessary raises serious concerns over the appropriateness and reliability of accounting (and auditing) practices in relation to the recognition of contingent liabilities.

In linking the parent company (JHI NV) to claims against other companies within the group, social pressure effectively forced Hardie to lift the corporate veil which it had been insisting made these moral liabilities ‘remote’. This has focussed attention on the ‘expectation gap’ between company law and contemporary social ‘norms’ of ethical behaviour – particularly for complex corporate groups. As expressed by the Commissioner:

“The circumstances (that have been considered by this Inquiry) have raised in a pointed way the question (of) whether existing laws concerning the operation of limited liability or the “corporate veil” within corporate groups adequately reflect contemporary public expectations and standards” (Jackson, 2004, para 30.67).

This particularly raises the possibility of either ‘single entity’ treatment of groups or of ‘successor liability’ legislation in Australia. In 2000, the Australian law in this area was addressed in the Companies and Securities Advisory Committee Report (CASAC). The Report recommended “that the existing principles of tort liability should not be changed for corporate groups” leaving open the strategy of ‘quarantining’ liabilities in subsidiary companies (CASAC (2000), Summary 0.13 and Chapter 4). However, the Hardie case has resulted in such issues being referred to the Ministerial Council for Corporations for review as “potential weaknesses in corporate law” (Horrigan, 2005).

Additional issues that have arisen through this case and that are now under review in Australia for possible change in corporate law, include the treatment of ‘long-tail personal injury claims’, ‘responsible corporate conduct’ (particularly in relation to corporate social responsibility) and ‘personal liability for corporate fault’ CAMAC (2006a, 2006b & 2006c).

The extent of companies obligations to stakeholders other than their shareholder ‘members’ is at the core issue in this case – particularly to those in society to whom a moral obligation is owed. Without changes to corporate law, it seems unlikely that many corporates will accept an

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16 It is notable that CSR Ltd (another former asbestos producer in Australia) has settled many hundreds of individual claims and, in 1989, “voluntarily lifted the corporate veil” when it reached “an agreement … with the West Australian Government Insurance Office” and “essentially handed over $20 million” to be apportioned between claimants” (Haigh, 2006, p. 151). However, in 2003 CSR ‘demerged’ its major trading operations from its asbestos linked activities and subsequently reported a provision of A$342 million and disclosed potential liabilities for “claims that cannot be reliably measured” (CSR, 2004, p. 65).
‘overriding’ obligation to society, despite owing their existence to the social contract. The actions of the New South Wales Government in the Hardie case, the current UK Companies Bill, and legislation introduced in a few other jurisdictions indicate an increasing willingness by political representatives to legislate for (at least) serious consideration of social and moral obligations. Directors, executives and, potentially, shareholders should heed this change in societal norms.

Conclusion

Like all commercial companies, Hardie operates under a mandate from society that is enshrined in company law: to increase financial wealth for its shareholders and to meet its economic obligations as a corporate citizen. It is argued, in social contract theory, that this mandate also implicitly requires companies to respect the ‘fundamental rights’ (for example to life, health and justice) of individuals and society while pursuing their commercial objectives.

In this case Hardie, or more correctly its directors, senior executives and their professional advisors, clearly breached this mandate – the social contract between society and business – over several decades. Only when faced with threats to their market share and profits, when under extreme media, political and judicial scrutiny, and when faced with dramatically escalating financial costs, were Hardie’s ‘governors’ forced to accept the social (moral) obligations from past activities.

Hardie’s history of neglect, denial and avoidance of their social obligations in relation to asbestos-related activities, apparently in single-minded pursuit of profit and shareholder wealth, became a national scandal in Australia. However, it may serve as a warning to other companies (at least in Australasia) of the dangers of ignoring society’s expectations of ethical standards of corporate behaviour.

The case of James Hardie Industries, it is argued, clearly illustrates that in instances of serious breaches of accepted societal moral norms it is indeed possible to enforce the social contract – even where an organisation has carefully adhered to current legal requirements and professional guidance. The consequences of organisations continuing to ignore their social and environmental responsibilities, and/or failing to adequately account for these, may include increased regulation. Organisations, their governors and professional advisors must now be alert to the dangers inherent in flouting the ‘general will’ of their society, under an implied social contract – and not simply observing the interests of immediate stakeholders including the capital markets.

We note, however, that despite the public opprobrium and the ‘unfunded’ financial cost of the final settlement, Hardie’s share price dipped very temporarily and that the senior executives involved received substantial severance payments and others remain in senior positions within the group. This leaves questions over the efficacy of simply financial penalties where serious breaches of ‘hypernorms’ are identified. It also raises doubts about the depth of support for socially responsible investment (SRI) in developed capital markets. Society, clearly evidenced ‘double standards’: while pointing the finger at Hardies’ directors and senior executives, other corporate and private investors were taking advantage of the financial gains from Hardies’ ‘aethical’ corporate activities.

This case raises many issues and questions to be addressed in continuing research, including:

- fuller analyses of cases, across theoretical perspectives, to assist in identifying effective ‘drivers’ of corporate decisions in situations of moral conflict – for example the different decisions made by CSR Ltd and Hardie in similar scenarios;
- the longer-term impacts of society’s reactions when moral norms are breached and the effectiveness of any subsequent penalties;
- whether recently strengthened corporate governance regimes will have any significant effect on long-term corporate social responsibility and accountability reporting; and specifically:
- whether the Hardie outcome has set a precedent that will indeed ‘pierce the corporate veil’ and establish a ‘successor liability’ doctrine outside of the US.

Consideration should also be given to these issues in the education of the next generation of managers and their professional advisors. At present, ‘...in spite of the enormous power these state created, purely legal, (corporate) entities possess, there is a mindless acceptance of the
status quo that permeates accounting education” (Association for Integrity in Accounting, 2004, p.5). The Hon Justice Owen (in the HIH Royal Commission Report) exhorted “(t)he education system—particularly at tertiary level—should take seriously the responsibility it has to inculcate in students a sense of ethical method” (Owen, 2003). Failure to do so, following the issues highlighted by the Hardie case, would appear to be irresponsible – and unethical.

Revolts against ‘corporate tyranny’, as seen in the Hardie case, indicate that the social contract is indeed alive (and well?) – although generally buried beneath shareholder, stakeholder, institutional and organisational legitimacy theories and practices. This case (and similar examples of corporate abuses) may also revive the debate among accounting and management professionals and educators, based on Rousseau, Locke, Hume, Rawls and more recent writers, over corporate responsibility and accountability to their respective ‘societies’.

At the very heart of the Hardie case is the moral issue of whether financial legal responsibilities to the members of companies should have so clearly dominated over fundamental obligations to their community – particularly those of the life and health of individuals. As expressed by Owen:

“(r)ight and wrong are moral concepts, and morality does not exist in a vacuum. I think all those who participate in the direction and management of public companies, as well as their professional advisers, need to identify and examine what they regard as the basic moral underpinning of their system of values. They must then apply those tenets in the decision-making process” (Owen, 2003).

Having heard all the evidence in the HIH Inquiry, Justice Owen stated “(f)rom time to time as I listened to the evidence about specific transactions or decisions, I found myself asking rhetorically: did anyone stand back and ask themselves the simple question—is this right?” (Owen, 2003). This question could be asked with even more force of the human consequences of suffering and death in the asbestos industry – and by the ‘governors’ of ‘ethical’ corporations. Corporate governance now entails a responsibility to ensure that the social contract is observed, or boards should be prepared to defend their non-compliance.
References


Exhibit 1 – The principal James Hardie Companies

**James Hardie Industries Ltd** (JHIL) – the former public holding company floated in 1951 (initially James Hardie Asbestos, named changed in 1971). Now ABN 60 with two subsidiaries:

- James Hardie & Coy Pty Ltd (JH & Coy) – the initial family company incorporated in 1918 and the principal asbestos trading company. Subsequently Amaca Pty Ltd.
- Jsekarb Pty Ltd – formerly James Hardie Brakes and Hardie-Ferodo – now Amaba Pty Ltd.

**James Hardie Industries NV (JHI NV)** – the Dutch parent of the current Hardie group listed as JHX on the Australian Stock Exchange (ASX) and operating through subsidiaries in US, Australia, New Zealand, The Philippines, Chile and Europe.

Exhibit 2 Companies Bill (House of Lords) 2006

**Sec 173 Duty to promote the success of the company**

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote 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.