



Retrospective

Controversial Business Practices in 2018

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Executive Summary

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

At Inrate, we have taken some time to look at the database with respect to the controversies in 2018 and to compile a list of controversial business practices which caught our attention during the last twelve months. Every chosen example is extraordinary in nature, even though for different reasons. The list includes controversies that were relevant because of the impact of the corporate conduct on environment and society as well as the perception of stakeholders thereof. Some of the controversies that emerged in 2018 or before saw significant updates during the past year. It is not a ranking of the controversies with the severest grades of 2018.

Major trends and the role of corporations

As previous years, 2018 has seen misconducts by corporations on a wide range of topics. Companies have been at the center of attention of the revelations of the #MeToo movement. A striking example thereof happened at CBS and led to the CEO's resignation from his position. A particularly interesting case in the light of the current trend of increasing data volumes concerns the business practices of Cambridge Analytica and insufficient data governance structures at Facebook. Another tech giant, Google (subsidiary of Alphabet Inc), was awarded a record fine of EUR 4.3 billion by EU regulators for abusing its market power.

Companies at the center of human tragedies

The year 2018 was also witness to tragedies such as the Northern California Wildfires (US), the most destructive fires in California's history. Even though unusual drought and winds were factors that might have contributed to the spark of some of the fires, investigators signaled that the improper maintenance of PG&E's electric infrastructure was the main cause. In Europe, even though the causes are not yet entirely clear, poor maintenance of the Morandi bridge by Autostrade per l'Italia (a

unit of Atlantia) in Genoa may have been one element contributing to the collapse causing 43 fatalities. Listeria, a major foodborne disease, caused 200 fatalities in South Africa since its outbreak in 2017. The origin of the outbreak of listeria was contaminated processed meat at a subsidiary of Tiger Brands. Finally, the medical device failure related to the faulty hip replacements of Johnson & Johnson, which led to serious consequences for patients, has not lost its relevance.

Responsibility for environmental degradation

Corporations were held responsible for environmental degradation. A striking example thereof is Bunge, one of the world's largest agribusiness companies. Bunge has repeatedly been accused for irresponsible supply chain management of soy and in 2018 was fined for illegal deforestation in Brazil.

Money laundering and accounting irregularities

At Danske Bank, the CEO resigned in September 2018 and the chairman was ousted in December 2018 after massive money laundering allegations. The bank has built a reserve of as much as USD 2.7 billion (85% of last year's net profit) in order to cover for potential fines. In terms of governance, the headlines were dominated by Carlos Ghosn and the allegations with respect to under-reporting his income at Nissan by around half over a period of five years.

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CBS

Sexual harassment allegations against CEO

Topic: Employment conditions

In the wake of a global protestation movement against sexual harassment, in August 2018, New Yorker magazine published a comprehensive investigation into alleged sexual misconduct and abuse at CBS Corp (New Yorker 2018a). Based on testimonies from six employees and former employees, the article accused CEO and company president Leslie Moonves, as well as other male executives, of repeated sexual abuse and harassment of women within the company. The article states that the alleged acts took place during more than two decades, between the 1980s and the end of the 2000s. The article also highlighted a corporate culture that has been allowing such acts to occur for many years. Following these allegations, the Board of Directors launched an independent investigation. A shareholder class action lawsuit was filed in August 2018 against CBS, arguing that the company failed to disclose material information for investors on this case. In September 2018, Leslie Moonves, the CEO of CBS was forced to resign after six more women alleged sexual misconduct by him. CBS also announced to donate USD 20 million to organizations supporting the #MeToo movement and that amount would be deducted from Leslie's severance package (New Yorker 2018). As for now (December 12, 2018), the internal

investigation is still ongoing and Leslie Moonves has neither been legally sued nor received any severance package. Among other revelations, management members at the highest level, happened to know about the misconduct of Leslie Moonves against female employees.

Inrate's view: Inrate considers the nature of the controversy to be significant, as the misconduct of the former CEO of CBS had far-reaching consequences for his victims. All employees or former employees of the company involved in this case have suffered serious acts of moral and physical harassment, often repeatedly. In addition, according to reports, some of the victims were forced to have sex or risked losing their jobs. In many ways, the company bears its share of the responsibility in this matter: First, the case is far from being limited to the former CEO, since other male executives or journalists have been the subject of allegations and legal proceedings. Articles and reports point out a widespread culture of abuse of power at CBS. Then, as the case of Leslie Moonves, whose actions began in the 1980s, shows, sexual abuse against employees has a long history in the company. Finally, and most importantly, there is ample evidence that management has been informed of the wrongdoing, but instead of managing the risk, has failed to take appropriate action.

Facebook Inc

Cambridge Analytica data breach scandal

Topic: Content and privacy of customers' data

In March 2018, a class action lawsuit was filed against Facebook and British consulting firm Cambridge Analytica for disclosing private information of users (ABC7 Chicago 2018). It was revealed that Facebook illicitly allowed a third-party, Cambridge Analytica, to use data via an app for more than four years. The data gathered was not limited to the 300,000 participants of a personality test but included all the friends of the respective users amounting to private data from more than 80 million users of the social media platform. The gathered data was then evaluated and used in attempt to influence public opinion on political debates such as the US presidential campaign in 2016. Facebook was aware of claims related to this security breach two years before revealing the practice while the company's CEO Mark Zuckerberg later admitted wrongdoings with regards to the handling of data (The Guardian 2018). Since the breach went public, the CEO testified at several hearings in front of the US Senate and the EU parliament about data protection and the tech firm's responsibility (NZZ 2018). The company was recently fined for the relatively low amount of EUR 600,000 by UK's information regulator for its role in the breach. However, it is projected that the EU could impose a much higher fine under the General Data Protection Regulation (GDPR) (Forbes 2018).

Inrate's view: Inrate considers this controversy as significant as the data was misused for political purposes that eventually had an impact on major elections. The sensitivity of data shared was not a major concern in this case as users of the social media platform gave consent through their privacy settings. The focus was rather on the illicit acquisition of information by the third party and the data usage for such services without users' knowledge. Although the direct liability lies with Cambridge Analytica, Facebook contributed indirectly but still in a major way to the controversy by failing to establish adequate safeguards.

Alphabet Inc

Imposing illegal requirements on device manufacturers (EU)

Topic: Anti-competitive practices

In 2018, the European Commission (EC) imposed a fine of EUR 4.3 billion on Google (subsidiary of Alphabet Inc.) for breaching EU antitrust rules. According to the Commission, Google's scheme for cementing its market power of its search engine included three types of contractual restrictions on Android device manufacturers and network operators. Google required numerous manufacturers to pre-install the company's own apps (e.g. Google search app and the browser app "Chrome") as a condition for licensing the company's own app store. Furthermore, the company made payments to phone makers to exclusively pre-install certain apps as well as required approval for using any alternative version of Android (European Commission 2018). Conversely, Google has appealed the decision arguing that Android had increased consumer choice rather than reduced it (Business Insider 2018a). The most recent case is the third investigation of the Commission against Google since 2010 (Financial Times 2018). In 2017, the Commission fined Google EUR 2.4 billion for abusing its position by treating its own comparison shopping service preferentially (European Commission 2018). In 2016, the Commission argued that Google prevented websites using its product AdSense from displaying search advertisements from Google's rivals (Reuters 2018).

Inrate's view: The fine for Google's abuse of its dominant position is the largest antitrust penalty imposed by the European Union and among the largest with regards to anti-competitive practices. This case outlines Google's practices to retain the dominance of its search engine by means of contractual restrictions on Androids operating system. Inrate considers this controversy as significant due to the systematic lock of the market by limiting competitors with creating barriers to entry. This case further helped to spark the discussion on whether tech firms have grown too powerful and the regulatory

challenges of such business models faced by legal institutions.

Pacific Gas and Electric Corporation (PG&E)

Northern California Wildfires (US)

Topic: Local communities / Impact on local communities

“The North Bay Fires” broke out in October 2017 and rapidly spread across 250,000 acres affecting six counties in Northern California. The fire destroyed more than 14,700 homes, 728 businesses and 3,600 vehicles (Business Wire 2017). More than 20,000 residents were displaced, 43 people died, 185 were injured and 2,269 went missing (ABC News 2017, Business Wire 2017). The incident caused more than USD 9 billion in damage claims (The Press Democrat 2018). In November 2018, a second fire occurred in Butte County, California. The so called “Camp Fire” left more than 88 dead and destroyed more than 150,000 acres, 13,000 homes and 500 commercial properties. The damage was estimated to be between USD 7.5 and USD 10 billion (San Francisco Chronicle 2018, California Department of Forestry and Fire Protection 2018). What might have been the most destructive fires in California’s modern history and the costliest in US history allegedly broke out in several points of the improperly maintained electrical infrastructure of the Pacific Gas and Electric Corporation (PG&E) (Business Wire 2017, Press Democrat 2018).

The company faces more than 200 lawsuits from residents, local governments and insurance companies over property damage, economic losses, private and public nuisance, as well as violations of the California Public Utilities Code and the California Health & Safety Code, among others. The cases are still under investigation but the first results of the research of the California Department of Forestry and Fire Protection came out in May 2018 (Reuters, 2018a). They showed that PG&E violated state code by failing to remove the vegetation close to the power lines that sparked three wildfires in 2017 (The Press Democrat 2018a). In the case of the Camp Fire it was evidenced that a day before the incident, PG&E detected sparks on its high-power lines

located very close to the place where the blaze started (AP News 2018). Investigators signaled the fracturing of a badly maintained steel hook that held a high voltage line on a transmission tower of the company as a second possible cause (NBC 2018).

The company said it expects to pay more than USD 2.5 billion but pushed to reduce its liability in the legislature and in the courts (Reuters 2018a, AP News 2018a). It declared that the fires occurred following unprecedented weather conditions including drought and strong winds and that it complies with removing vegetation and inspecting its electric infrastructure each year. To keep PG&E from going bankrupt and because investigators determined that the company’s equipment started only some of the fires, lawmakers decided on September 2018 to pass some of the costs on to customers in their monthly bills (San Francisco Chronicle 2018a).

Inrate’s view: The Northern California fires are the most destructive in California’s history and the most expensive in US history. The blazes left more than 130 people dead and burnt more than 400,000 acres, destroying the home and commercial properties of thousands of people. Even when unusual drought and winds were factors that might have contributed to the spark of some of the fires, investigators signaled that the improper maintenance of PG&E’s electric infrastructure was the main cause. The company might be liable for more than USD 2.5 billion. This might have led to its bankruptcy had the government not approved to pass on some of the costs to the customers. Finally, as of November 2018, the PG&E stock had lost almost half of its value (CNBC 2018). Inrate considers this controversy as significant given the irreversible and extended impact on private and public property, on the forest and on the stakeholders.

Atlantia

Bridge collapse in Genoa (Italy)

Topic: Health impact of products and services

On August 14, 2018, a section of the Morandi bridge on the A10 motorway in Genoa collapsed and caused 43 fatalities. In September 2018, the Italian prosecutors have opened an investigation of 20 managers at Autostrade per l'Italia (a unit of Atlantia), the company in charge of the bridge maintenance (BBC News 2018).

The bridge was built in the 1960s and became a renowned landmark of Genoa. Its designer, Riccardo Morandi, conceived a simple structure without redundancies. Over time doubts were raised about the resilience of the bridge. In the late 1990s, parts of the bridge were refurbished, but not the part which collapsed in 2018. After that, no more major renovations were carried out (The New York Times 2018).

In October 2017, Autostrade per l'Italia commissioned Carmelo Gentile, a professor at the Politecnico di Milano, to conduct a test for damage. After the test, Mr. Gentile had raised doubts about the structural safety of the bridge and stated that Autostrade per l'Italia has not followed up on the recommendations. According to the company, the professor's recommendations were taken seriously, but the urgency was not perceived. The company had included the recommendations in a proposal to retrofit the bridge and submitted it to the Ministry of Infrastructure. However, the Ministry of Infrastructure delayed the authorizations of the plans (The New York Times 2018).

Inrate's view: Inrate considers this controversy as significant due to the number of people who lost their life in the accident. The causes and responsibilities for the accident are not yet clear. Several elements – among them poor maintenance of the bridge – seem to have played a role.

Tiger Brands Ltd

Products recall due to the outbreak of listeria (South Africa)

Topic: Health impact of products and services

The outbreak of the dangerous foodborne disease listeriosis in South Africa has been ongoing since the beginning of 2017. Between January 2017 and March 2018, 978 laboratory-confirmed cases were reported and more than 200 people died (Business Insider 2018). The causing bacteria, *Listeria monocytogenes*, can contaminate animal products as well as vegetable and fruits. Especially pregnant women, little children and older people are prone for severe disease (Fin24 2018).

In March 2018, it was discovered that the origin of the outbreak was contaminated processed meat and the source was a subsidiary of Tiger Brands Ltd., an Enterprise Foods factory in Polokwane (South Africa). Tiger Brands immediately recalled the affected products and was forced to shut down their enterprise facilities at three locations (Fin24 2018, Business Live 2018). Furthermore, several African countries suspended all imports of processed meat from South Africa (Business Live 2018).

At the end of 2018, a lawsuit was filed and it is expected that Tiger Brands may end up paying between SAR 0.1 million (USD 7,000 USD) and SAR 2 million (USD 141,000) to each of the families of victims who died from listeriosis (Business Insider 2018).

Inrate's view: Tiger Brands was found to be the source of the largest listeria outbreak worldwide so far with more than 200 deaths. Inrate considers this controversy significant as many people died due to the lack of sufficient food safety measures of the company. The suspensions of processed meat product imports from South Africa by other African countries will lead to a negative impact for the economy. Additionally, the outbreak caused a relevant uncertainty among the retailers and consumers until the source of the listeria outbreak was found which caused recalls of products.

Johnson & Johnson

Faulty hip replacements

Topic: Health impact of products and services

A case which started more than a decade ago has still not found its end in 2018. Already in 2005, the Articular Surface Replacement (ASR) – a hip replacement of De Puy Orthopaedics, a division of Johnson & Johnson – became available on the market (The New York Times 2013). It soon turned out that the product had its flaws. The metal-on-metal hip replacement caused potentially deadly side effects, such as metallic erosions that led to serious consequences for the patients, since chromium and cobalt started to dissolve and caused severe damages on bones, tissues and organs (Consumer Reports 2016).

In August 2010, Johnson & Johnson started to recall its ASR hip replacement systems for a total of about 93,000 pieces worldwide. Thousands of lawsuits were filed against the company in the US, Europe, Canada, India and New Zealand. More than 10,000 patients were contacted to have their surgeries reviewed (Reuters 2013). Only three years later, in 2013, another medical hip replacement device of the same company, the so-called Pinnacle Acetabular Cup System, was taken off the market (Reuters 2016). By 2015, Johnson & Johnson paid as much as USD 4.4 billion to settle 9,000 lawsuits concerning the ASR hip replacement system (Drugwatch 2018).

At the end of 2017, 2,000 direct claims of patients regarding the ASR Hip Replacement Systems and 10,000 in respect to the Pinnacle Acetabular Cup System were still pending according to Johnson & Johnson (Johnson & Johnson Annual Report 2017). In December 2018, Johnson & Johnson agreed to pay more than USD 400 million to settle about 3,300 out of 10,000 pending Pinnacle Acetabular Cup System lawsuits in the US (Bloomberg 2018b). In late 2018, Johnson & Johnson negotiated a settlement with the Indian government for about 4,700 affected patients (Reuters 2018b). In November 2018, the Indian health ministry announced that compensations will soon be paid. No payments have been effected yet (Livemint 2018).

Inrate's view: Inrate considers this controversy as significant since this medical device failure is by far one of the biggest product liability cases in the medical sector in the last decade. The products have been marketed without sufficient studies on potential side effects. Thousands of people around the globe have been affected and suffer from lifelong consequences and had to have additional surgeries. The company has already paid USD 4 billion to settle 9,000 ASR hip replacement claims.

Bunge

Sourcing deforestation-related soybeans

Topic: Resources use or damage to ecosystems during production

Two of Bunge's major soy suppliers, SLC Agrícola and BrasilAgro, have legally deforested 19,683 ha of native vegetation in PiauÍ, a state in northeast Brazil, from 2011 to 2017. The deforestation took place despite Bunge having published a public zero-deforestation commitment. Thereby, Bunge and its suppliers take advantage of the Brazilian Forest Code, which requires private landowners in the Cerrado (including PiauÍ) to maintain only 35 percent of land as legal reserves (in contrast, legal reserves in the Amazon must cover 80 percent). This leaves room for soy producers to legally deforest native Cerrado vegetation (Aidenvironment 2017).

In the period from 2010 to 2017, large areas of forest land – 123,917 ha - were cleared for soy production in PiauÍ. The accelerated deforestation rates accompanying the large-scale soy production go along with negative environmental and social impacts in the southwest of this state. The environmental impacts include agrochemical pollution, diminishing biodiversity and natural resources such as water. The social impacts include negative impacts on health as well as unethical business practices such as land grabbing and the intimidation of traditional communities living in these areas (Aidenvironment 2017).

In March 2017, it was reported that Bunge Ltd was responsible for massive deforestation across South America. Thereby, Bunge was linked to more than 1.4 million acres of deforestation

between 2011 and 2015. As a consequence, Bunge Ltd faced pressure to implement supply chain reforms from customers and investors around the globe and to sign the Brazilian Amazon Soy Moratorium to stop selling soy grown on newly deforested land (Mighty Earth 2017, Facing Finance 2017). In May 2018, Bunge Ltd was fined - together with Cargill Inc, ABC Indústria e Comércio SA, JJ Samar Agronegócios Eireli and Uniggel Proteção de Plantas Ltda – USD 6.5 million for illegal deforestation by the Brazilian Environmental Agency (IBAMA). The companies were fined due to alleged purchases of 3,000 metric tons of soy from areas illegally deforested and protected under Brazilian law. The fine was split among the five companies. Bunge Ltd announced a statement that the soybean purchases in the area where it was fined were in line with best practices (Reuters 2018c).

Inrate's view: Inrate considers this controversy as significant as Bunge is one of the world's largest agribusiness companies and has in the last years repeatedly been reported to be involved in large-scale deforestation occurring in South America, including mainly the regions of the Gran Chaco (Argentina), the Bolivian Amazon and the Brazilian Cerrado. In 2018, the company was fined for the first time for deforestation by the Brazilian authorities. The amount of the fine is comparably small, but it confirms the companies' involvement in illegal deforestation. Although Bunge has committed to stop deforestation, the still existing various involvements in deforestation along the company's supply chain show serious room for improvement.

Danske Bank

Violation of anti-money laundering rules

Topic: Money laundering

In September 2018, the money laundering scandal at Danske Bank has grown to "gigantic proportions" (EUobserver 2018). With the start of a probe in September 2018 by U.S. law enforcement agencies over allegations of massive money laundering flows from Russia and other post-Soviet states, the scandal reached a global scale (Wall

Street Journal 2018). While there are still a lot of unknowns, more than USD 227 billion of suspicious transfers originating in post-Soviet countries may have been rinsed through the bank's Estonian branch over several years through 2015 (The Economist 2018). The non-resident portfolio transaction volume peaked in 2013 with the number of 80,000 transactions. Not all transactions were likely to have been illicit, but all came from post-Soviet clients (EUobserver 2018). Consequently, the CEO of Danske Bank resigned in September 2018 and the chairman was ousted in December 2018 at an extraordinary general meeting, initiated by the largest shareholder, the owner-family of the Maersk shipping imperium. The bank has built a reserve of as much as USD 2.7 billion (85% of last year's net profit) for covering potential fines (The Economist 2018).

It all begun with an order by the Danish Financial Supervisory Authority (FSA) in 2012 to ensure that Danske Bank should control its correspondent banks to have sufficient control procedures to reduce the risk of money laundering. In March 2016, the FSA reported a violation of Danske against the Danish anti-money laundering rules by not fulfilling this 2012 order. The controversy continued with its preliminary peak in 2018.

Meanwhile, global banks such as Deutsche Bank AG and Citigroup Inc. were approached by a whistleblower complaint about transactions to and from the Estonian branch of Danske Bank (Wall Street Journal 2018). Also, JPMorgan Chase & Co and Bank of America Corp. were also questioned by the US authorities for information on similar transactions (Bloomberg 2018a).

Inrate's view: Inrate considers money laundering as a major sustainability issue of the financial service sector. Although it is not the only controversy over money laundering in 2018, the controversy of Danske Bank is exceptional in its scale and duration. Recent history in European countries showed, such misconduct can endanger an institution when facing large size fines. Home countries of such institutions potentially suffer from facing global political pressure. Hence, not only the society of former Soviet countries were defrauded due to tax evasion, but Danish society may have to face the consequences of this misconduct.

Nissan Motor Co Ltd

Financial misconduct of Carlos Ghosn

Topic: Governance practices

In November 2018, the Chairman and CEO of the Renault-Nissan-Mitsubishi Alliance, Carlos Ghosn, was arrested for allegedly under-reporting his income at Nissan by around half as well as misusing company funds. Instead of his actual compensation of JPY 10 billion (CHF 88 million) from 2011 to 2015, only around JPY 5 billion (CHF 44 billion) were disclosed (BBC News 2018a). The allegations related to misusing company funds refers to sums paid to provide luxury homes in several cities without any business relevance and payments of around USD 100,000 a year to Ghosn's elder sister for a non-existent advisory role (The Guardian 2018a). Nissan had alerted the Japanese prosecutors following an internal investigation that was started based on the allegations of a whistleblower (The Business Times 2018). Following his arrest, Carlos Ghosn was dismissed from his position as a chairman of Nissan Motor Co. It is also expected, that Nissan Motor Co Ltd will propose to remove senior executive Greg Kelly, a close aide to Ghosn, also involved in the misconduct (The Guardian 2018a).

Before the misconduct became public, Carlos Ghosn used to be the chairman of all the three companies of the Renault-Nissan-Mitsubishi Alliance and acted as the CEO of Renault. The financial misconduct at Nissan Motor Co had consequences at Mitsubishi, where Carlos Ghosn was dismissed as chairman. Renault conducted an audit in the aftermath of the misconduct found at Nissan, but did not find irregularities with his pay and kept him on as chairman and CEO (The Globe and the Mail 2018).

Amidst the downfall of Carlos Ghosn, voices have surfaced questioning whether the arrest was in fact a conspiracy to shift the power balance within the Renault-Nissan-Mitsubishi Alliance. In 1999, Nissan was on the brink of bankruptcy, Renault bought a large stake and helped to stabilize the finances (Bloomberg 2018). Due to this, Renault holds 43.4% of Nissan, whereas Nissan holds only 15% of Renault (Nissan holds 34% of Mitsubishi) (Renault Nissan Mitsubishi Alliance 2018). In terms of vehicle sales of the alliance, Nissan accounted for most of them (5.8 million vehicles), Renault sold

3.8 million and Mitsubishi sold 1 million vehicles (Renault Nissan Mitsubishi Alliance 2018). The alliance is the largest automaker and sells one in nine vehicles worldwide.

Inrate's view: Inrate considers this controversy significant since half of the income of a top earner of a large stock listed company was not reported over a period of five years. As a consequence, Carlos Ghosn had to step down from his position as Chairman of Nissan and Mitsubishi which created instability in the Renault-Nissan-Mitsubishi alliance. The controversial behavior of Carlos Ghosn underlines the importance of corporate governance. At Nissan Motor Co Ltd the governance structures were such that Carlos Ghosn used to make the ultimate decision about the entire board's compensation (The Business Times 2018).

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