
UNION CARBIDE AFTER BHOPAL: LEARNING THE MANVILLE LESSON?

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The methyl isocyanate disaster in Bhopal, India and subsequent events have placed Union Carbide Corporation at a strategic crossroad. Company managers must balance their own interests and those of stockholders against the interests of Union Carbide's various other "publics," especially the Indian gas victims and their families. Executives of other firms, small and large, will benefit from consideration of the forces which constrain the Union Carbide managers as they attempt to deal with the remarkable circumstance they confront.

Manville Corporation stood at a similar crossroads in 1978, and made what most would agree was the wrong choice. That year opened with Manville reporting 623 asbestos lawsuits for amounts totalling \$2.8 billion. By year end, the company's situation had worsened markedly. Plaintiff attorneys had obtained incontrovertible written evidence that Manville executives had known the dangers of asbestos for decades and had suppressed publicity about asbestosis, the main disease the product causes. The U.S. Surgeon General had mailed 400,000 asbestos warning letters to the nation's doctors. Manville's then-retired chief physician had broken the company's wall of silence, telling of his understanding of asbestos diseases in the 1940s and his appeals to management to warn the public. Health, Education, and Welfare Secretary Califano had gone public with his estimate that as many as eleven million school children had been exposed to asbestos in U.S. classrooms.

Manville decided to "aggressively defend" the asbestos lawsuits, thereby maximizing legal costs, to disclaim prior knowledge of asbestos dangers, to seek a government bailout, and, finally, to try to sustain the company's immunity against its victims' claims by filing for bankruptcy reorganization. Manville executives and directors kept their corporate indemnity, pay, and perquisites, and Manville stock retained some market value. But few of the more than 20,000 asbestos victims have been compensated. Will Union Carbide show a similar insensitivity to the poison gas victims in India and Americans who feel endangered by the company's U.S. operations? Despite the apparent good intentions of Union Carbide CEO Warren Anderson, there is reason to expect that the answer will be, "Yes."

Reasons for Defensiveness

There are several reasons why Union Carbide is likely to assume a defensive posture. First, the company is already besieged by a number of major lawsuits. Melvin Belli filed a class-action suit for \$15 billion. David Jaroslawicz, a less prominent attorney, sought class-action status for 50,000 prospective plaintiffs. Another suit, in Chicago, demanded \$50 billion. Teams of Indian attorneys formed affiliations with American law firms to sign up plaintiffs. The Indian government has refused Union Carbide's offer of \$2 million in aid as a "pittance" and commissioned the Indian Law Minister to seek recompense for victims in U.S. courts. A leading Indian official has said that compensation for deaths and injuries must be in accordance with American standards, not the much lower standards existing in India. Faced with such a barrage, it will be hard for Union Carbide officials to keep from developing the type of "siege mentality" of which Manville executives have been accused.

Second, like Manville, Union Carbide is headed by an attorney. This may mean that the principles of adversarial justice practiced in American courtrooms will color Union Carbide's responses to the disaster. In the courtroom it is fine, of course, for the defense attorney to say only positive things about the defendant and for the prosecutor to say only negative things. It is well accepted that neither side has responsibility to present, or even acknowledge, "the whole truth." There is a judge, and sometimes a jury, to sort through the admittedly biased presentations of the two sides and to issue more or less fair and binding edicts. In the much broader arena in which the Bhopal tragedy and its aftershocks will be played out, there is not the controlled circumstances of the courtroom. Consequently, it is unlikely that anything approximating justice will result from an adversarial process there, just as it has not in the Manville case.

The third, and perhaps most important, reason that Union Carbide may quickly become defensive in its pronouncements and actions is the personal vulnerability of the company's executives and directors. As was the case at Manville, it will be hard for top officials to disclaim responsibility. The four most highly-paid executives of Manville Corporation in 1982 had all been with the company for 30 years or more. Union Carbide executives have similar tenures today. Chairman Warren Anderson, for example, went to work for the firm in 1947. Mr. Anderson has another problem: he has a chemistry degree in addition to his law degree, justifying the presumption that he knew something about methyl isocyanate. Thus, it will be especially difficult for Mr. Anderson to avoid accountability if, indeed, the corporation itself is responsible. This has already been brought home to Mr. Anderson, at least symbolically, by his arrest and brief detention in India and by the signs saying "Hang Anderson" which reportedly greeted him at one stop.

There is a growing sentiment in America to hold corporate executives responsible for the negligent torts their companies commit, although the legal sanctity of the corporation, coupled with universal executive indemni-

fication agreements, has so far prevented widespread application of this principle. Despite public sentiment, there would be little practical risk for the Union Carbide leaders if, as Mr. Anderson suggests, the company's financial posture were unlikely to be materially hurt by the potential claims. However, the chairman may be "whistling past the graveyard." Union Carbide's book value has recently been in the range of \$5 billion. But the company's market value hovered around \$3.5 billion even before the Bhopal disaster. The company's claimed \$200 million in liability insurance is unlikely to be adequate. Further, as the Manville case has shown, insurers do not automatically pay massive toxic tort judgments. Manville insurers fought among themselves, fabricating a "manifestations" versus "exposure" debate, while threatening to claim managerial culpability if the initial ruse failed. Union Carbide can expect the same resistance, though perhaps on some other basis. Anyway, punitive damages, a real possibility, cannot be covered by insurance. In light of Union Carbide's weakening financial condition, discussed below, and the impending loss of profits from its methyl isocyanate plants, it would take only a few hundred million dollars in negative cash flow to force rapid retrenchment.

Short of outright failure, the costs of the disaster are likely to be partly reflected in reduced executive compensation and benefits. Also, the forthcoming washing of Union Carbide's dirty linen in public is likely to soil the reputations of the managers. It may have been the likelihood of personal economic injury to Manville executives and directors, more than any other factor, which gave that company an incentive to take over Olinkraft (roughly equivalent to a criminal's "marrying a good woman," according to one writer) in 1978, and to follow the other defensive strategies mentioned earlier. Even today, the necessity to keep Manville viable so that it can indemnify its executives and directors gives the company an incentive to covet its income from the highly profitable, though devastating, asbestos business. Manville's plant in Nashua, New Hampshire, for example, continued in 1985 to use 50,000 pounds of asbestos fiber a week. Further, the firm's "divestiture" of its Canadian asbestos mine involved the sale of stock to Manville's Canadian executives under an agreement that most of the cash flow from the mine would continue to go to Manville. A decision by the U.S. Environmental Protection Agency in early 1986 to prohibit future use of asbestos is expected to eliminate U.S. sales of the product. It is conceivable that Union Carbide might try to keep its methyl isocyanate profits through some similar sham. The fear of potential economic injury to executives and directors may turn out to be stronger than the concern for the Bhopal victims and the desire to prevent future poisonings. The tenacity with which Union Carbide defended its right to continue making methyl isocyanate in West Virginia adds credence to this argument.

A final reason that a siege mentality is likely to develop at Union Carbide, as it did at Manville, is that the company was already in a weakened financial condition. Union Carbide's return on assets dropped smoothly from 7.2

percent in 1980 to 0.8 percent in 1983, while return on equity fell from 15.1 percent to 1.6 percent. From its high in the second quarter of 1983, the company's stock lost one-third of its value **before** the Bhopal disaster, wiping out \$1.7 billion in owner wealth. Value Line asserted, "Union Carbide still isn't out of the woods." The company did report higher profits for 1984, but stock price tended downward throughout the year.

The parallel with Manville Corporation is striking. Manville was going deeper into the woods in 1978. During the succeeding four years, that company's sales, in 1981 dollars, fell from \$2.92 billion to \$1.64 billion and profits crashed from \$144 million to an \$89 million loss. In the same period, Manville's common stock price fell about seventy percent. Despite this, and the steadily mounting numbers and success rates of asbestos lawsuits, Manville executives pretended everything was okay until Coopers and Lybrand qualified their audit opinion and Moody's and Standard and Poor's downgraded Manville's debt in early 1982.

As was the case for Manville, the official optimism of Union Carbide's management was not reflected in the financial markets. In just ten days after the Bhopal tragedy, the Union Carbide shares lost nearly one-third of their already-depressed value. Standard and Poor's reported that institutions held about fifty-seven percent of Union Carbide's shares at year end 1983. This implied great downside volatility for the stock because such investors tend to have similar ideas about when to sell — for example, when two quarterly dividends are skipped, or when company debt is downgraded. If expectations had continued to worsen, new financing would have been hard to obtain. Even with strong financing capability and with the methyl isocyanate-related income — but without the distraction of Bhopal — Union Carbide executives were having a hard time keeping the company profitable. After the incident, that job was much tougher. It should be noted that Union Carbide's earnings performance became much less visible after the firm charged off about \$80 million in assets as part of a major restructuring during 1985.

Justifying Defensive Measures

There are a number of arguments, of varying validity, which can be used to justify any defensive measures Union Carbide takes. First, it can be argued that contingency-fee lawyers who have rushed to sign up potential claimants in India and petition U.S. courts prevent the settlement of the claims in a timely and equitable fashion. A Rand Corporation study showed that only about one-third of the costs of asbestos litigation against Manville actually took the form of payments to claimants. Of course, like Manville, Union Carbide has the ability to make sure legal expenses are maximized and benefit payments minimized to enhance the effectiveness of this argument in the future. It will be easy to claim, also, that the litigation to determine which courts have jurisdiction must be completed before benefit payments can be made. That process alone may take years. Incidentally, as

occurred in the Manville case, the longer the company can wait to settle claims, the more of those claims will be converted from personal injury cases to wrongful death cases. Judgments for disabling injuries tend to be much higher than wrongful death judgments.

Another argument is that the Indian government and Indian managers and engineers contributed to the disaster. Of course, there are restrictions in India on the importation of technology. Undoubtedly these can be construed as having limited Union Carbide's ability to install the latest instrumentation at the Bhopal plant (although the "equipment" and "procedures" were at first claimed to match those at the West Virginia plant). Also, the desire of the Indian government to have foreign-owned plants managed and manned by Indian nationals may appear to account for any shortage of American management and engineering talent existing at the plant. Of course, there is some risk in using this kind of argument. Because of the recognized sophistication of American managers and engineers, allowing a U.S.-owned hazardous plant anywhere in the world to be operated without their effective control could be seen as preparing a defense **in anticipation** of a possible tort.

Another likely defensive assertion is that allowing large settlements of the methyl isocyanate claims might result in thousands of Union Carbide employees being cast out into the streets when the company fails or retrenches. The magnitude of the Bhopal disaster has reportedly affected morale throughout the Union Carbide organization. All employees and managers were, of course, saddened by the misery and death. Moreover, they are all much less economically secure than they were. If the costs related to the incident are in the billion-dollar range or higher, paying the claims will necessitate extensive retrenchment. However, such fears may be unfounded. If costs beyond the company's available cash flow must be paid, funds can be obtained through the sale of divisions. Union Carbide is a conglomerate, with many unrelated businesses. The company frequently buys and sells businesses, without disemploying anyone. Since 1977, Moody's reports Union Carbide has sold at least seventeen different operations — buying others during the same time period, of course. When a division of a conglomerate is sold, it is not necessary that anyone lose a job. So the specter of massive unemployment because Union Carbide might be required to pay claims is a questionable one.

Conclusion

In summary, Union Carbide must decide whether its strategic focus will be upon treating the poison gas victims and their families fairly and preventing a recurrence, recognizing that the cost may be very great, or upon protecting the company's managers and stockholders. There are many forces at work which tend to force Union Carbide into a defensive posture. There are even a number of arguments, some valid, some not so valid, which can be used to justify and rationalize defensive measures which may be

taken. In one striking example of an appropriate response, Johnson and Johnson, the maker of Tylenol, concentrated upon removing Extra Strength Tylenol from shelves all over the world when seven Chicagoans died after taking the product. It was clear within hours that the fault in that case was not Johnson and Johnson's; yet the company gracefully endured costs exceeding \$20 million. This case is obviously not parallel to the present situation involving Union Carbide; but it does illustrate how a conscientious management team can focus on corrective action rather than self-defense in the face of huge tort liabilities. It is interesting to note that Johnson and Johnson is reported to have regained ninety-five percent of its previous market share within two weeks.

If Union Carbide does decide to emphasize human considerations rather than financial ones, what kinds of strategies might be available? First, of course, it may be in Union Carbide's long-term best interest to stop making methyl isocyanate. The costs may outweigh the benefits for making the product anywhere in the world. It is said to be more poisonous than phosgene (the poisonous gas used during World War I) and, at least in most processes, has well-known and less-dangerous substitutes. Certainly, technology has not advanced to the stage where such a dangerous product can be made in huge quantities near population centers with absolute safety. The highly publicized series of leaks at Union Carbide's West Virginia factories in August 1985 reinforces this conclusion. American companies can be criticized for carrying out such processes in other countries, even Third World ones, while prohibiting them at home.

Finally, Union Carbide could immediately attempt to arrive at a conclusion about what is appropriate settlement amounts for the categories of injury which exist in Bhopal. Then the company might aggressively try to make payments to claimants. Of course, the court systems in the United States and India are likely to assess greatly varying damages for similar injuries. Handling so many cases through the courts will also result in extensive delays. If Union Carbide is sincere, however, the company itself, with the help of respected public figures, can make reasonable judgments about settlements. If the amounts are, for example, halfway between what Union Carbide's costs are expected to be in adjudicated cases and the amounts, perhaps one-third as much, which claimants actually expect to receive, many of the injured Indians and the families of the deceased would quickly settle. The window of opportunity here, though, is small. Every day that passes increases the disincentives which Union Carbide managers have to handle the matter forthrightly and decreases the confidence which others have in the company's wish to do so.

In fact, the option of being truly socially responsible may have already been taken away from the Union Carbide executives. In September 1985, the company's stock price was buoyed by takeover threats. Apparently, the institutions who hold most of the common stock realize that new management might not feel the compunction which troubles current management

and would not expend corporate resources unnecessarily. Coincidentally — or perhaps not — the most credible takeover threat came from GAF Corporation, a Manville codefendant in many asbestos lawsuits.

Sir Thomas More said (in Bolt, *A Man for All Seasons*), “If virtue were profitable, common sense would make us good, and greed would make us saintly.” If the Manville experience offers a clear lesson for Union Carbide executives, it is that when massive toxic torts occur the price of virtue can be extremely high. If Warren Anderson can lead his company to take the high road it will be against overwhelming odds — but he will have earned the respect of America.

