

**The latest in problems at BP, in Prudhoe Bay, provide a poignant background to considering the question of what role pension fund trustees have when it comes to matters of corporate governance and social responsibility.**

Let's start with a bit more context. In March 2005 an explosion at BP's Texas City refinery killed 15 people and injured many more. In April last year it was also fined for unsafe operations at its Oregon, Ohio refinery. Now, on top of the largest oil spill ever in Alaska's North Slope region we have BP's pipeline problems, which whistleblowers have been flagging for more than two years against an internal control culture reportedly more focussed on targeting the whistleblowers than the actual problems.

The most common misconception that arises in this context is that trustees' only and overriding objective is profit maximisation. Does this mean you should only have regard for such risks once there is a de facto, material impact on profits and share price, i.e. after the fact?

Clearly that is not and should not be the case and I would like to offer an insight into trustee's legal duties, drawing on advice Freshfields provided for the UNEP Finance Initiative. That misconception is based on a misunderstanding of the legal position in UK. The classic citation, wrongly used to promulgate it, is the Cowan v Scargill case. However, given the misrepresentation of that case, the Judge took the unusual step of re-visiting his judgement in print a few years later. He clarified that the case did not support the thesis that profit maximisation alone and solely was consistent with the fiduciary duty of a pension fund trustee.

So what are the duties? First, trustees must exercise their fiduciary powers carefully and fairly for the purposes for which they were granted and not for any ulterior purpose. Secondly, their fiduciary powers must be used in the best interests of the present and future beneficiaries. Thirdly, other non-fiduciary duties do apply, including those under the general law of negligence (reasonable standard of care) and under contract law (general duty to apply due skill and care).

In essence trustees need to act as 'prudent business people', balancing risks and returns in the best interests of their beneficiaries, setting and monitoring performance against appropriate benchmarks as the basis for measuring future financial performance.

Trustees need to disclose in their Statement of Investment Principles (SIP) the extent, if at all, to which social, environmental and ethical considerations should be taken into account and the policy if any of



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directing the exercise of the rights (incl. ownership rights) attached to their investments. It's not just about disclosure though. Trustees need to be au fait with what their SIP says about these things and that the knowledge and understanding expected of them on investment includes governance issues.

Trustees are not restricted to acting exclusively in the financial interests of the beneficiaries. They can take account of social, environmental, ethical and governance issues in achieving added non-financial benefits, as well as in promoting the objectives of the scheme. They can do this to the extent it is reasonably expected to deliver unchanged or even improved financial benefits to the beneficiaries. Acting in good faith and having taken proper advice, they should ensure that their advisers and fund managers are taking proper account of the impact of these issues on long term financial performance.

So what about BP? As one financial analyst put it in the International Herald Tribune article 'Seeking to right its U.S. ship, BP turns to a Texas oilman' (12 July 2006), "It is difficult to say if this is a BP wide issue, but they appear to cut corners for the sake of short-term profit maximisation. If you are a serial under-spender in a refinery, it will come back to haunt you." On top of the impact on employees and others, we now have fines, rectification costs, ballooning exposure to litigation and the reputational damage done.

Add to this the current debate about the environment, greenhouse gas emissions and how organisations should pay for their impact and you begin to see a wealth of relevant issues that warrant consideration.

So what might trustees be doing at the moment? Now may be a good time for them to brush off their fund's SIP to see whether it is adequate and meaningful. They might also want to ask their fund managers how they have been implementing the policy and using the ownership rights in cases such as this. Trustees need to ask themselves what they think a prudent business person should be doing.

To quote the words of a famous philosopher "It is not only for what we do that we are held responsible, but also for what we do not do."

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The opinions expressed are those of Aviva investors as at 2 October 2006.