

Fair Law:

Legal Proposals to Improve Corporate Accountability for Environmental and Human Rights Abuses

Written by:

Filip Gregor, GARDE programme of the Environmental Law Service

Hannah Ellis, The Corporate Responsibility (CORE) Coalition

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European Coalition for Corporate Justice

The European Coalition for Corporate Justice is the largest civil society network devoted to corporate accountability within the European Union. The European Coalition for Corporate Justice critiques policy developments, undertakes research and proposes solutions to ensure better regulation of European companies to protect people and the environment. The European Coalition for Corporate Justice's membership includes more than 250 civil society organisations in 16 European countries. This growing network of national-level coalitions includes several Oxfam affiliates, national chapters of Greenpeace, Amnesty International, Friends of the Earth, the Environmental Law Service in the Czech Republic and the Corporate Responsibility (CORE) Coalition, the Dutch CSR platform and the Fédération Internationale des Droits de l'Homme (FIDH).

Further Information:

Ruth Casals, Coordinator, The European Coalition for Corporate Justice

Tel: +32 (0)2 5420187

Address: 15 Rue Blanche, 1050 Brussels

Email: info@corporatejustice.org

Website: www.corporatejustice.org

Executive Summary

The first Multinational Enterprises (MNEs) can be traced back in law to the industrial age, amongst a backdrop of vast improvements in global transportation, rapidly expanding manufacturing industries and emerging notions of free trade. New legal structures were required to accommodate the huge sums of capital needed to fuel the industrial expansion. The new corporations were provided with unique structures and privileges – separate legal personality, limited liability for shareholders and the ability for the company itself to become a shareholder in other companies (full legal capacity). These three pillars of corporate structure continue to form the basis of the legal corporate form today.

The underpinning of the company structure in this way has, however, had undesired consequences. Implicit in this structure is the notion that a company should act solely in the economic interests of its shareholders. This accountability to the owners of the company has often been at the expense of the company's accountability to other key stakeholders such as workers, local communities affected by the companies operations, and to society at large. States have generally failed to reform relevant legislation in order to address this accountability gap for a number of reasons. One significant practical obstacle has been the international law principle of non-intervention. This prevents a state from regulating the whole MNE, only the part of the company registered within that state. Secondly, there are requirements in the European

Community (EC) for free European Market access – EC law gives only limited scope for a Member State to regulate its imports. International initiatives aimed at addressing the accountability gap also leave much room for improvement.¹

However, as this briefing describes, there are a number of regulatory reform measures that the European Union could take to help improve the accountability of MNEs. This improved accountability would help reduce the current adverse international environmental and human rights impacts of companies based in the Europe but with a wider operational reach, as well as international companies that operate within the European market. Further, the measures proposed would ensure that MNEs with responsible environmental and human rights practices are not placed at a competitive disadvantage within the EC.

The European Coalition for Corporate Justice has prepared this legal briefing in response to the recent European Parliament resolution on Corporate Social Responsibility² and in

1. Some of the guidance adopted by intergovernmental organizations, such as the 1976 OECD Guidelines for Multinational Enterprises, the 1977 ILO Tripartite Declaration Concerning Multinational Enterprises and Social Policy (revised in 2000), and the 1992 UN Rio Declaration on Environment and Development, have explicitly emphasised the role of MNEs and stated what their obligations should be. None of them went so far as to actually introduce binding obligations for MNEs. Although drafts of laws obligating MNEs directly have been proposed, most notably the Draft UN Code of Conduct of Transnational Corporations and The UN Norms on the Responsibilities of Transnational Corporations, neither has successfully been agreed in law.

2. European Parliament, Committee on Employment and Social Affairs, Report on CSR : A New Partnership, (2006/2133(INI))

conjunction with a parallel report “*With Power Comes Responsibility: Legislative opportunities to improve corporate accountability within the European Union*”, which reviews how these proposals could be applied to existing cases of corporate abuse³.

Three key areas of reform are proposed, as outlined below.

Proposal 1: Enhancing Direct Liability of Parent Companies

MNEs operate as a single economic entity, normally through the coordination of a number of separate legal persons. The twin concepts of separate legal personality and limited liability insulate each member of the MNE from the obligations, civil or criminal, of the other members of the economic group. This is a fundamental principle of company law, protecting entrepreneurs from financial risks connected with their operations beyond the sums initially invested, and hence encouraging investment. However, this has created a “double standard” in which a parent may receive profits from its subsidiary’s operations without exposing itself to any liability for the environmental or human rights consequences of those operations. This significant limitation on the legal liability of parent companies has the effect of discouraging MNEs, both from a legal and financial perspective, from effective environmental and human rights management of the whole enterprise.

The European Coalition for Corporate Justice believes that the most effective way to improve compliance with human rights and environmental standards by business enterprises in their out-of-EU operations would be to suspend the effects of the doctrine of separate legal personality in relation to the areas of human rights and the environment. Responsibility for such violations should be allocated to the companies that are able to control the entity that actually violated the standards.

Proposal 2: Establishing a Parental Company Duty of Care

There are a number of situations where MNEs can decisively influence the operations of other legal persons that are not formally part of the company group, but which are economically dependent on the group, such as joint ventures and suppliers. Under existing European laws, the duty of care of the parent company with respect to the affiliate’s operations is limited to specific situations where the parent is directly involved in the operations or is in fact driving the affiliate’s decisions. While this limited legal responsibility may not have deterred certain MNEs operating in brand sensitive sectors from improving their supply chain management, it has generally discouraged parents from better and more transparent management of environmental and social impacts within their sphere of responsibility.

The European Coalition for Corporate Justice believes that a company should have a duty of care to ensure that human rights and the environment are respected throughout its sphere of responsibility. A company should be held legally liable if it cannot adequately demonstrate

3. The European Coalition for Corporate Justice (2008) “*With Power Comes Responsibility: Legislative opportunities to improve corporate accountability within the European Union*”, available at www.corporatejustice.org.

it has adhered to this duty. That is, it has taken all reasonable steps to prevent and/or end the violations. Thus, parental duty of care would be expanded to all situations where the parent could significantly influence the operations of other legal persons with which it has business relationships, or more precisely the adverse impacts these legal persons have on human rights and the environment.

Proposal 3: Establishing Mandatory Environmental and Social Reporting

A proposed obligation for MNEs to conduct environmental and social reporting (ESR) seeks to complement proposals 1 and 2 by improving the transparency of MNEs, thereby indirectly promoting accountability. Although many MNEs use ESR as a voluntary tool, it has several inherent limitations. Firstly, information is often provided selectively, ignoring the MNEs' most significant environmental and human rights impacts. Secondly, it is very difficult to hold companies liable for any inaccuracies in the reports. Thirdly, due to the absence of common standards, the information provided cannot be compared with other MNEs, let alone against an objective standard.

The European Coalition for Corporate Justice believes effective ESR should include the following information about an MNE and its performance:

1. The enterprise structure and its sphere of responsibility;
2. The risks of human rights and environmental abuses within the MNE's operations or the operations within its sphere of responsibility,

and the measures adopted to prevent such abuses; and

3. Data on direct and indirect social and environmental impacts of the MNE's operations in the preceding reporting period according to a specified and standardised set of performance indicators.

This will ensure that MNEs report on what is important with respect to their impacts on human rights and the environment and that the information contained within the report is accurate, comprehensive and comparable.

This report provides an overview of what legal deficiencies each of these proposals would address; articulates legal text for European law of the proposals; highlights key legal options arising from the proposals; suggests further reforms to existing directors' duties to ensure effective uptake of the proposals; and proposes reforms to civil and public liability to ensure effective enforceability of the proposals. As this report shows, through changes in European law, there are significant improvements that could be made to accountability mechanisms that would contribute to the improved behaviour of MNEs, wherever they operate.

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Introduction

The first Multinational Enterprises (MNEs) can be traced back in law to the industrial age, amongst a backdrop of vast improvements in global transportation, rapidly expanding manufacturing industries and emerging notions of free trade. The Joint Stock Companies Act of 1844 in England, and subsequent legislative developments internationally, cemented the basis of company operations in law. The new corporations were provided with unique structures and privileges – separate legal personality, limited liability for shareholders and the ability for the company itself to become a shareholder in other companies (full legal capacity).

However, underpinning company structure in this way has had undesired consequences, shielding MNEs from liability for human rights and environmental abuses and other public-interest law violations. Implicit in the structure is the notion that a company acts solely in the economic interests of its shareholders. This imperative has often sidelined companies' accountability to society at large. Even accountability to shareholders is often hypothetical - limited to the right of shareholders to elect directors and to sue those same directors for breach of fiduciary duty. The result is that decisions with far-reaching effects on employees, communities and the environment occur with no input from those stakeholders or the wider public and under very little oversight, even from shareholders.

When applied to the MNE's structure, this legal framework has resulted in a governance gap, as national regulations conventionally apply only to

constituent parts of the MNE operating in the territory of the state concerned or territory concerned. The company may receive profits or other benefits from operations of other parts of the MNE located outside that particular state jurisdiction, without exposing itself to any liability for the human rights or environmental consequences of those operations. In the event that the state hosting those operations does not punish such violations, the MNE can benefit from complete impunity benefiting from the additional profits generated by such conduct whilst avoiding liability for the human rights and environmental costs.

European states have so far failed to implement legislation to ensure the effective accountability of Europe-based MNEs for their operations abroad for a number of reasons. One significant practical obstacle has been the international law principle of non-intervention in the affairs of another state. Thus a state is prepared only to regulate those parts of an MNE registered within that state itself. Another is the requirement in the EC for free European Market access. EC law gives only limited scope for Member States to regulate imports, even through indirect measures.

International initiatives to ensure effective corporate accountability mechanisms have also not produced the desired effects. Since the United Nations Universal Declaration of Human Rights of 1948, there have been a number of international treaties referring to evolving human rights standards and environmental protection. However, these treaties, although binding on states, are generally not binding on MNEs. Although it could be argued that MNEs are also legally bound to

respect human rights – at least those belonging to customary international law or to the general principles of law, there is no binding mechanism currently in existence at the international level which ensures accountability for any violations.⁴

In March 2007, the European Parliament passed a resolution on Corporate Social Responsibility (CSR) that recognised the need to improve the accountability framework in which European business operates.⁵ This view has been echoed by the UN Special Representative of the Secretary General,⁶ encouraging states to exercise their duty to protect human rights.⁷

The European Coalition for Corporate Justice believes there are significant opportunities within European law to improve accountability of both those MNEs operating in the European market and those based in Europe with operations

4. Some of the guidance adopted by intergovernmental organizations, such as the 1976 OECD Guidelines for Multinational Enterprises, the 1977 ILO Tripartite Declaration Concerning Multinational Enterprises and Social Policy (revised in 2000), and the 1992 UN Rio Declaration on Environment and Development, have explicitly emphasised the role of MNEs and stated what their obligations should be. None of them went so far, though, as to actually introduce binding obligations for MNEs. Although drafts of laws obligating MNEs directly have been proposed, most notably the Draft UN Code of Conduct of Transnational Corporations and The UN Norms on the Responsibilities of Transnational Corporations; neither has successfully been agreed in law.

5. European Parliament, Committee on Employment and Social Affairs, Report on CSR: A New Partnership, (2006/2133(INI)).

6. A Special Representative of the Secretary General on human rights and transnational corporations and other business enterprises has been following the perceived failure of the UN Norms on Responsibilities of Transnational Corporations and given a mandate to review current practices and provide recommendations. UN Doc. E/CN.4/RES/2004/116.

7. Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises: Protect, Respect and Remedy: a Framework for Business and Human Rights, John Ruggie, April 2008.

overseas. This legal briefing has been prepared in response to the European Parliament's CSR Resolution and provides an overview of a range of concrete legislative proposals that aim to help businesses operating in the internal market better manage human rights issues and their environmental footprint around the world. Further, the measures proposed would ensure that MNEs with responsible environmental and human rights practices are not placed at a competitive disadvantage within the EC.

Over the last twelve months, the European Coalition for Corporate Justice has compiled research and held a series of consultations with company law specialists, CSR academics and civil society groups to evaluate the current obstacles to corporate justice and consider what changes to EU law could help prevent human rights abuses and environmental degradation within the sphere of responsibility of European MNEs. This briefing paper builds on the findings of this research and makes proposals which endeavour to invigorate the debate in Europe on corporate justice. It has been produced in parallel with another European Coalition for Corporate Justice report, "*With Power Comes Responsibility: Legislative opportunities to improve corporate accountability within the European Union*", which reviews how these proposals could be applied to existing cases of corporate abuse.⁸

The proposals contained in this report are intended to bring about a greater balance between the financial rewards of an MNE's operations and

8. The European Coalition for Corporate Justice (2008) "*With Power Comes Responsibility: Legislative opportunities to improve corporate accountability within the European Union*" available at www.corporatejustice.org.

the legal responsibility that it has for human rights and the environmental. The proposals touch the heart of company law and are based on reforms in three areas:

1. Strict liability of parent companies for abuses of their subsidiaries;
2. Establishing a duty of care to prevent abuses in the corporate sphere of responsibility; and
3. Mandating environmental and social reporting.

These proposals lay out new responsibilities for parent companies based in, or otherwise connected with the European Union, and aim to address some of the failings of existing legal structures, including the lack of responsibility of parent companies for misconduct of subsidiaries and contractors these parent companies have the ability to control and the current absence of adequate remedies for victims of corporate misconduct.

Proposal 1:

Enhancing Direct Liability of Parent Companies

1.1 Overview

MNEs operate as a single economic entity, normally through the coordination of a number of separate legal persons. The twin concepts of separate legal personality and limited liability generally insulate each member of the MNE from obligations, civil or criminal, of the other members of the economic group.⁹ This is a fundamental principle of company law, protecting entrepreneurs from financial risks connected with their operations beyond the sums initially invested, and hence encouraging investment. However, this has created a “double standard” in which a parent may receive profits from its subsidiary’s operations without exposing itself to any liability for the environmental or human rights consequences of those operations. These legal concepts, developed to encourage investors to inject capital into new enterprises, are now being used to enable those enterprises to disregard their moral and social responsibilities.

9. The separate legal personality of a company means that it has a different legal existence from the shareholders. A company may sue and be sued in its own name and holds property separately from its shareholders. As such, the shareholders do not own the assets of the company and are not liable for its debts. These assets and liabilities belong only to the company. It is this separate legal personality that makes companies an attractive vehicle for commercial ventures, as liability rests with the company, rather than with shareholders, directors, members of the board or company officers. The separate legal entity forms the basis for limited liability of shareholders. Shareholders' liability is limited to the value of the shares allotted to them.

The reality of an MNE operating as a single economic entity has had some legal recognition, challenging the notion of separate personality. The European Court of Justice (ECJ) for example, has made several judgments imposing penalties on foreign parents with regard to EC competition law.¹⁰ In relation to financial reporting, parent companies are required to prepare consolidated financial statements that include the accounts of subsidiary undertakings in accordance with the European Seventh Company Directive on Consolidated Accounts.¹¹ The single economic entity perspective is also a feature of some international soft law such, as the OECD Guidelines for Multinational Enterprises.¹²

The functioning of an MNE as a single entity is not, however, normally recognised in relation to its environmental and human rights impact.

10. E.g. in the *Dyestuffs* case, the ECJ adopted the economic entity doctrine by concluding that three non-EC undertakings had participated in illegal price fixing within the EC through the use of subsidiary companies located within the EC but controlled by non-EC parents. *Case 48/69 etc ICI v Commission* [1972] ECR 619. Although the economic entity doctrine has been criticised for not respecting company law doctrine of separate legal personality, the EC courts and the Commission have relied on the economic entity approach on a number of subsequent occasions. See e.g. *Genuine Vegetable Parchments Association OJ* [1978] L 70/54; *Johnson and Johnson* [1981] 2 CMLR 534.

11. Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3) (g) of the Treaty on consolidated accounts (*OJ L 193, 18.7.1983, p. 1–17*). This directive requires the parent to produce annual accounts (but not the company’s environmental and social accounts) consolidating financial information about it and its subsidiaries irrespective of where these subsidiaries are established. A “subsidiary undertaking” is considered relevant where the parent has controlled ownership of shares, or other rights to exercise dominant influence over the subsidiary, or if it actually exercises such influence. See Art. 1 and 2 of the directive.. The duty to draw consolidated accounts is also recognised in the standards of the United States' Financial Accounting Standards Board, and the International Accounting Standards Board.

12. See point I.1 of the OECD Guidelines for Multinational Enterprises. Available at <http://www.oecd.org/dataoecd/56/36/1922428.pdf>

Under existing law, a parent can only be held liable for environmental and human rights violations where the company clearly failed to adhere to its duty of care,¹³ if it authorised or abetted the violation,¹⁴ or where the corporate structure has deliberately been used to advance fraud or other illegal or wrongful purposes. This significant limitation on a parent's legal liability has discouraged MNEs, both from a legal and financial perspective, from effective environmental and human rights management of the whole enterprise. In some cases it has allowed wilful abuse. Furthermore, due to the existing requirement to prove that the parent participated in the relevant abuse, remedying and punishing breaches is extremely difficult and rarely achieved. This is of particular concern when the MNEs extraterritorial operations occur in countries with a limited rule of law that prevents effective remedies being carried out against the wrongdoing subsidiary.¹⁵

13. A duty of care can be recognised where the parent knows about the violations and actually exercises direct and close control over its subsidiary's operations. Claims of failing such duties were raised in litigation in the United Kingdom, where foreign direct liability of parent in United Kingdom was a central issue – *Connely v. RTZ* [1998] AC 854, *Lubbe v. Cape plc*. [2000] 1 WLR 1545, *Ngcobo v. Thor Chemical Holdings Ltd* [1995], *Sithole v. Thor Chemical Holdings* [1999].

14. Such liability is explicitly envisaged by certain environmental statutes, such as the U.S. Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. § 9601–9675), Canadian Waste Management Act, R.S.B.C. 1996, c. 482, or, most recently, European Environmental Liability Directive 2004/35/EC (*OJ L 143/58, 30.4.2004, p. 56-75*). Examples also exist in criminal law. Recently, a French court has found the company *Total* liable on this basis for a criminal offence as regards the tanker *Erika* disaster. *Erika*, interestingly, was operated by a subcontractor of Total's subsidiary. However, this case did not have an extraterritorial element. It should be also noted that the court's decision is under appeal.

15. In such situations, economical obstacles play a very significant role. Countries with a low rule of law are usually economically very weak and so are their citizens. Often it may be the case that victims of the abuses do not enjoy basic personal freedoms. The ability of victims of abuse to bring the case to court in home state of the parent company, even if

The European Coalition for Corporate Justice believes that the most effective way to improve observance of human rights and environmental standards by business enterprises in their out-of-EU operations would be to suspend the effects of the doctrine of separate legal personality in the area of human rights and the environment. Responsibility for such violations should be allocated unconditionally to the company having the right to control the entity that actually violated the standards - in short, to the parent company.¹⁶

This would result in the parent being liable in the same way as if it were the wrongdoer itself. A claimant would not have to prove, as it is currently required, that the parent owed it a duty of care in respect of the subsidiary's operations and that the duty had been breached. The only pre-condition for the parent's liability would be the right of the parent to control the wrongdoer. The liability for the violation itself would be then judged by reference to the MNE as a single enterprise. In most cases this would include only an analysis as to whether there is:

it has jurisdiction over it, is thus very limited.

16. There are rare examples where a similar approach has already been adopted, specifically in the U.S. jurisdiction. For example US 1990 Americans with Disabilities Act (42 U.S.C. § 12101), or 1964 Civil Rights Act, that imposes on all American employers covered by the Acts an obligation to monitor the compliance of all the corporations they control in foreign countries with the prohibitions stipulated in those Acts. Further, as put by Schutter in the Amoco Cadiz Oil Spill Case (1984 A.M.C. 2123, 2 Lloyd's Rep 304 (N.D. Ill. 1984)), it is such an 'enterprise' approach which the District Court of Illinois has adopted, even in the absence of any legislative mandate, in order to conclude that the parent corporation should be held liable for environmental damage caused by an oil spill from a tanker off the coast of France. The close degree of control of the parent corporation over its subsidiaries allowed the court to overcome the separation of legal personalities. (De Schutter, O., Extraterritorial Jurisdiction as a tool for improving the Human Rights Accountability of Transnational Corporations, Faculté de Droit de l'Université Catholique de Louvain, 2006).

- a. Causation between the wrongdoer's acts (or omissions) and the damage or injury;
- b. Negligence (or any intent) of the wrongdoer as required by law.

The following chapter provides an overview of the legal text that could be used to introduce a new parent company liability in European law; an overview of key legal questions arising from the proposal; proposals in relation to improving directors' duties; and possible reforms to civil and public liability to ensure effective enforceability.

1.2 Legal Text

The following legal text summarises the core of the first European Coalition for Corporate Justice proposal. This legal text is not intended to provide definite language, but defines the proposal as a high level principle to be implemented in European law and the laws of the Member States.

1. An undertaking (a parent undertaking) which has the right whether through ownership, contract or any other relationship to exercise control of another undertaking (a subsidiary undertaking) shall be liable for non-contractual losses, damages, costs and other expenses arising out of personal injury or damage (whether economic or to property) suffered as a result of a breach of human rights or damage to the environment caused by the subsidiary undertaking.

For the purposes of this article, foreign persons shall have the same right of access to courts of the Member States where a relevant parent

undertaking is located, or has substantial operations, as the nationals of that Member State. "Foreign persons" are persons who were not resident in any Member State at the time they suffered any relevant loss or damage outside a Member State.

2. A parent undertaking shall be liable for effective, proportionate and dissuasive sanctions in any case in which it or a subsidiary undertaking abuses, or is aiding or abetting an abuse, of human rights and environmental standards expressed in international conventions listed in Annex III of the EU Generalised System of Preferences.

Members of the public in the state in which proceedings are to be brought and any other person who is or may be affected by the conduct complained of, shall have access to judicial procedures to challenge such abuses and to require imposition of sanctions.

3. These provisions apply whether the conduct complained of takes place inside or outside the European Union.

4. The authority to determine the liability of a parent undertaking shall fall in the jurisdiction of:

(i) The courts and public authorities of the Member State where the parent undertaking is incorporated; or

(ii) In the event that the parent undertaking is not incorporated in any of the Member States, the courts and public authorities of any Member State in which territory a parent undertaking has a

substantial operation.

Appointed courts and public authorities may decline jurisdiction only where:

(i) In private matters, proceedings for the same cause of action have been commenced against the parent or subsidiary undertaking in another jurisdiction and such a claim has a reasonable prospect of being heard in a timely and fair process which is not prejudicial to the human rights of the claimant.

(ii) In public matters, proceedings in which sanctions may be imposed on the parent undertaking for the same default have been commenced in another Member State.

5. The parent undertaking's liability shall be determined in accordance with the laws of the forum. This shall not require a foreign subsidiary undertaking to be treated as if it were subject to the public law regulations of the forum.

6. Nothing in this clause shall relieve the subsidiary undertaking from any liability.

1.3 Further Legal Questions

There are several legal questions arising from the imposition of this proposal. Those of central relevance are:

1. How would the proposal be applied and enforced against parent companies that are not incorporated within the European Union?

2. What would constitute a parent company's right to exercise control?
3. Under public law, what would be the scope of the public or criminal offences that could be prosecuted in the Member States when committed extraterritorially?
4. What would be the applicable law in cases of abuses taking place extraterritorially?

Outlined below is a summary of how the European Coalition for Corporate Justice believes these issues should be addressed.

1.3.1 Enforcement against parent companies that are not incorporated within the European Union

On the basis that EU parent companies will be liable as set out above, non-EU parent companies should not be able to profit or seek competitive advantage within the EU by being able to profit from human rights or environmental abuse. Any access of MNEs to the European market should be based on internationally recognised human rights and environmental standards. To protect MNEs based in the EU against unfair competition, and to prevent MNEs avoiding potential liability through relocating the parent to a third country, the European Coalition for Corporate Justice proposes that the jurisdiction of the European courts be extended to parent companies of MNEs operating in Europe that are not incorporated within the European Union. In order to ensure effective enforcement, in such cases where the foreign parent does not have assets within the European Union, the assets of any element of the MNE operating in the EU shall be available to meet the relevant parent's liabilities. Similar approaches

have been taken in English law, for example, in order to enforce employee pension obligations.¹⁷

EU jurisdiction law, in relation to civil matters, is currently governed by the Brussels I Regulation.¹⁸ The European Coalition for Corporate Justice proposes that this regulation be amended. Under the Brussels I Regulation, the jurisdiction of the courts in the proceedings against defendants who are not domiciled in the European Union varies, as this is dependent on Member State law.¹⁹ This regulation would have to be amended to ensure that cases against parent companies domiciled outside the EU, if they carry out substantial operations within the Single European Market, could be heard in an appropriate jurisdiction. In line with established case law of the ECJ and the Court of First Instance (CFI), such jurisdiction could be based upon the presence of operations carried out either directly by the parent company or indirectly by its subsidiaries and they could consist of sales as well as production.²⁰

1.3.2 The Right to Exercise Control

Parent company liability should exist where the company has a real ability to exercise control over a subsidiary or affiliate. The Seventh Company Directive on Consolidated Accounts²¹ defines a parent undertaking based on ownership of shares, or other (e.g. contractual) rights to exercise a dominant influence over the subsidiary, or if it actually exercises such influence, e.g. by appointing executive or management officers of the affiliate.²² The European Coalition for Corporate Justice believes that the definition of the right to control should be primarily based on these rules. That is, it shall be recognised in any circumstances where the parent company has a definite right (based on ownership or contractual or other relationship) to exercise a dominant influence over the subsidiary. However, control may also arise from purely contractual business relationships with no (or limited) ownership e.g. from franchise or other complex contracts. The definition of control should require courts to enquire into the true economic as well as legal

17. UK Pensions Act 2004, available at http://www.opsi.gov.uk/acts/acts2004/ukpga_20040035_en_1 The description of powers of the relevant state authority is available at: <http://www.thepensionsregulator.gov.uk/aboutUs/powers.aspx#acting>

18. Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters. (*OJ L 012, 16. 01. 2001, p. 1 - 23*)

19. *Ibid*, Article 4.

20. The Court of First Instance in the competition case of *Gencor v Commission* [1991] 4 CMLR 971, has upheld the Commission's prohibition on merger of two South African companies that were not incorporated in the European Community. The Court, inter alia, examined whether the case fell in the European jurisdiction. It acknowledged that the Merger Regulation required that the parties should have a substantial operation in the EC, but stated that these operations could consist of sales as well as production.

21. See Article 1 of the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3) (g) of the Treaty on consolidated accounts, (*OJ L 193, 18.7.1983*). Accordingly a company is considered to be a subsidiary where a parent undertaking: (a) has majority of shareholders' voting rights, (b) has the right to appoint or remove a majority of the members of management or supervisory body and is at the same time a shareholder of that undertaking, (c) has the right to exercise a dominant influence over an undertaking, pursuant to a contract, (d) is a shareholder of an undertaking, and (aa) a majority of the members of management or supervisory bodies have been appointed as a result of the exercise of its voting rights, or (bb) controls alone, pursuant to an agreement, a majority of shareholders' voting rights. The Member States may consider an undertaking to be a subsidiary of a parent undertaking if the latter (a) actually exercises a dominant influence over it, or (b) it and the subsidiary undertaking are managed on a unified basis by the parent undertaking.

22. *Ibid*, Art. 1 Accordingly, if parent undertaking is in such position with regard to other (subsidiary) undertakings, it shall include financial information about it in its consolidated accounts.

relationship between entities.²³

Ultimately, however, it must be recognised that control may not pass vertically up through economic structures. Where a company is participating in certain types of joint ventures, or is a minority shareholder, or where it manages its semi-dependent suppliers, it may be more appropriate to determine the liability of the parent company according to the requirements of a duty of care. Proposals for enhancing the duty of care in this respect are outlined in chapter 2 of this briefing.

1.3.3 Scope of Public Offences

There is a real or perceived risk that expanding the scope of MNE liability would violate the sovereignty of non EU states. Objections may also be raised that the regulation undermines international trade rules set by the World Trade Organisation (WTO). The European Union and its Member States should therefore restrain from making MNEs operating in the European market liable extraterritorially for more than what can be justified on the basis of the interests of the international community, as defined in international treaties and customary law.

The European Coalition for Corporate Justice suggests that the scope of public offences can be defined as that relating to relevant international treaties, as listed in Annex III of the EU

23. Companies are adept at segregating economic benefit from legal control when it suits them to do so (usually for tax reasons). As put in the introduction, the European Coalition for Corporate Justice's proposals are predicated upon balancing the financial rewards of an operation with legal responsibility.

Generalised System of Preferences (GSP).²⁴ This list provides a comprehensive overview of core human and labour rights set out in UN/ILO Conventions and environment and governance principles including the Convention on the Rights of the Child, the Convention concerning Forced or Compulsory Labour and the Convention on Biological Diversity.²⁵

The European Coalition for Corporate Justice believes that an act or course of conduct that leads to or aids or abets the violation of those conventions shall be deemed to be a public or criminal offence for which the parent company of the MNE, that operates in the European market and whose constituent was the perpetrator, should be held liable within the European jurisdiction. There is already precedent in the laws of European states in respect of extending their jurisdiction to extraterritorial human rights crimes, albeit based on different justification – the universality principle.²⁶ A number of European

24. Effective implementation of these treaties is a prerequisite set by GSP regulation for granting a special trade incentive arrangement for sustainable development and good governance to vulnerable countries. EU GSP is set by Council Regulation (EC) No 980/2005, of 27 June 2005. (*OJ L 169 30.6. 2005, p. 1-43*)

25. A full list of the relevant conventions available at http://trade.ec.europa.eu/doclib/docs/2005/june/tradoc_12391_0.pdf.

26. All EU Member States are bound by the Geneva Conventions of 12 August 1949 and by the Additional Protocol of 1977, and have ratified the 1984 Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment. Accordingly, they are obliged to 'provide effective penal sanctions for persons committing grave breaches' of those conventions, and either to 'bring such persons, regardless of their nationality, before its own courts', or to 'hand such persons over for trial to another High Contracting Party concerned, provided such High Contracting Party has made out a prima facie case'. The international law does not require states to establish a universal jurisdiction over other human right abuses, but laws of some states do establish such jurisdiction over genocide and crimes against humanity in general, for example the German Code of Crimes against International Law (*Gesetz zur Einführung des Völkerstrafgesetzbuchs*), BGBl. 2002 I, p.

states prosecute, at least in theory, the most serious abuses of human rights – crime of genocide, war crimes and crimes against humanity and human persons, and so does the International Criminal Court (ICC), although not against legal persons.²⁷

There are also instances where states employ extraterritorial jurisdiction in areas other than human rights. This is traditionally the case with competition law, including EC competition law.²⁸ Another precedent was set by the 1977 U.S. Foreign Corrupt Practices Act²⁹ which provides that it shall be unlawful practice for any ‘United States person’ to engage in practices of corruption abroad. This approach has been consequently reflected and sanctioned in international law, notably in the OECD Bribery Convention,³⁰ and the 2003 UN Convention against Corruption.³¹

A further example of national law with extraterritorial effects is the U.S. Alien Tort Claim

Act³² that provides that: “[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.” Although the far-reaching effects of this provision were unplanned when the Alien Tort Claim Act was enacted in 1789, it has allowed foreign victims of serious human rights abuses committed by corporations with sufficiently close links to the U.S., to seek damages in U.S. courts.³³

1.3.4 Applicable Law

Rules governing the applicable law are currently defined in relation to civil non-contractual matters within the Rome II Regulation.³⁴ This regulation generally rules out the possibility of the application of European law in extraterritorial cases and thus the potential application of this proposal. According to Article 4 thereof, the courts shall apply the law of the place where the damage occurred. However, legislators have recognised a special position of environmental claims and defined an exception for such cases. Persons seeking compensation for environmental damage can choose to apply the law of the country where event(s) giving rise to the damage occurred,³⁵ e.g. mismanagement on the part of the parent company.

2254, Federal Gazette, June 26, 2002), the Spanish Organic Law 1985/6 (Ley Organica 6/1985, de 1 de julio, del Poder Judicial). For more on this subject see: Schutter, O., The Role of EU Law in Combatting International Crimes.

27. The International Criminal Court was established by the Rome Statute of the International Criminal Court, adopted on 17 July 1998 by the United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court. The Rome Statute is an international treaty, binding only on those states which formally express their consent to be bound by its provisions. Today, 105 States have become parties to the Statute.

28. See notes 10, 20.

29. 15 U.S.C. §§ 78dd-1, et seq.

30. 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, available at http://www.oecd.org/document/21/0,2340,fr_2649_34859_20_17813_1_1_1_1,00.html.

31. Text of the Convention is available at <http://www.unodc.org/unodc/en/treaties/CAC/index.html>.

32. 28 U.S.C. § 1350

33. For more on questions of extraterritoriality see De Schutter, O., *Extraterritorial Jurisdiction as a tool for improving the Human Rights Accountability of Transnational Corporations*, Faculté de Droit de l'Université Catholique de Louvain, 2006.

34. Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations. (OJ L 199/40, 31.7.2007, p. 40-49)

35. Ibid, Article 7.

The European Coalition for Corporate Justice proposes this exception should be amended in two ways:

1. It should also include cases of personal injury resulting from other human rights abuses;
2. The choice-of-law rule should change from *lex loci delicti*, that is, the law of the country where events gave rise to the damage, to *lex fori*, that is, the law of the country of the court hearing the case, in order to ensure uniform applicability of parent liability in respect of foreign based parent companies, and to avoid an investigation into whether the local law permitted the relevant breach.

These provisions regarding the choice of applicable law would extend only to civil claims. Further, it would not be intended that EU public law provisions, such as health and safety, environmental or advertising regulations would be “exported” beyond the EU boundaries.

1.4 Directors’ Duties

Directors are traditionally accountable for a corporation’s financial well-being, but are rarely accountable for the social and environmental impacts of their decisions. In order to ensure effective observance of human rights and environmental standards, directors should also be held legally accountable for these impacts.

The European Coalition for Corporate Justice proposes that directors should be liable to

exercise a duty to take reasonable care to ensure that the company and any of its subsidiaries and affiliates adequately respond to risks of human rights and environmental abuses in the operations of the MNE.³⁶ While it may not be appropriate to hold directors strictly liable for MNE abuses, it would be feasible to expand their duty of care through establishing appropriate systems within the company to address such risks.³⁷ There is some indication of movement in this area, such as in the recently reformed UK law where directors are now obliged to have regard to the environmental and social impacts of their decisions.³⁸ However, this obligation has significant limitations as this duty is only to the company itself, undermining the core applicability and enforceability of the duty.³⁹

36. Such an approach is not uncommon in respect of other public interest laws. For example, in Canada, directors are obliged to exercise due diligence of company's observance with provisions of the Canadian Environmental Protection Act, or to face liability under this Act. Similar provisions can be found in a number of European jurisdictions, e.g., in the UK Environmental Protection Act 1990.

37. Dine formulated this approach as follows: “No longer will it be sufficient to impose a code of conduct to ensure that single stakeholders' interests are met, rather, [directors] should be considered as responsible for establishing systems specifically designed for that company which adequately address the risks of regulatory condemnation and bad publicity as well as systems which make the process of production work” (Dine, Janet: Companies, International Trade and Human Rights, Cambridge University Press, 2005, p. 272).

38. Section 172 of the UK Companies Act 2006 requires directors to 'have regard to', among other things, 'the impact of a company's operation on the community and environment'. In the *People's Department Stores Inc. v. Wise* ((2004) 244 DLR (4th) 564;), the Supreme Court of Canada held that, although lacking legislative mandate, "in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."

39. The adverse effects of such an approach may be illustrated by the ineffectiveness of the UK Companies Act 1985 that required directors to take account of the interests of employees, but provided enforcement mechanisms for this duty only to the company itself with the result that this has

A failure to comply with the proposed directors' duties would be punishable by public sanctions. In addition to public bodies, *locus standi* would be granted to other properly interested persons, such as certain non-governmental organisations protecting the affected public interests. Private enforcement of this public liability should be available only after actual human rights or environmental damage. In the view of the European Coalition for Corporate Justice, such a limitation is necessary in order to avoid the risk that such right to enforce directors' duties would be abused.

1.5 Methods of Enforcement

Reform of the law as set out above should in itself lead to a reduction in cases of corporate abuse; indeed the intent is to change corporate behaviour from the outset. However, such behaviour will only change if there are effective remedies available for victims of the consequences of corporate abuse. Reforms are needed to improve access to justice especially in the fields of financial obstacles and legal representation. Civil enforcement of remedies in the home states of the parent companies is extremely difficult under existing law,⁴⁰ as noted by the European

been (so far as positive enforcement goes) ineffective.

40. There have been several cases claiming foreign direct liability of parent in United Kingdom – *Connelly v. RTZ* [1998] AC 854, *Lubbe v. Cape plc.* [2000] 1 WLR 1545, *Ngcobo v. Thor Chemical Holdings Ltd* [1995], *Sithole v. Thor Chemical Holdings* [1999]. Other Foreign Direct Liability cases have been litigated in Australia and USA. According to Zerk, none of these cases reached judicial decision on their merits. Most of them were stayed or settled out of court. (Zerk, J. *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law*, Cambridge University Press, 2006)

Parliament.⁴¹ The ability of victims to claim exemplary damages would act as a deterrent to abuses and would, in particular, deter companies from counting on the financial disincentive upon victims (who may have suffered a relatively small amount of damage compared to the costs of enforcement) from seeking redress.

Public liability,⁴² which may include criminal liability, is currently generally only enforced by state attorneys or other state authorities. However, some states allow for citizens or victims to enforce public liabilities, such as in French penal law,⁴³ citizen suits in the United States⁴⁴ and Canadian environmental legislation.⁴⁵ In European law, consumer organisations have the right to seek injunctions against entrepreneurs who are in breach of the provisions of consumer law,⁴⁶ and the Aarhus Convention also stipulates

41. European Parliament resolution of 13 March 2007 on Corporate Social Responsibility: A New Partnership (2006/2133(INI)), p. 42: „... encourages the Commission to develop, in particular, mechanisms that ensure that communities affected by European companies are entitled to a fair and accessible process of justice.“

42. That is, claims (civil or criminal) brought by persons other than the direct victims themselves.

43. Code de procédure pénale, Article 2, Modifié par Ordonnance n°58-1296 du 23 décembre 1958 - art. 1 () JORF 24 décembre 1958 en vigueur le 2 mars 1959. Further, the French environmental code recognises as possible victims of environmental disaster the non-governmental environmental organisation. Thus, damages can be adjudicated to NGOs as compensation for the frustration of their long time and effort spent to protect the local environment, and also for costs of campaigning in certain cases. This was the case of the recent *Total/Erika* case. See note 6.

44. Such as the U.S. CERCLA § 9659, RCRA § 6972, EPCRA § 11046, Clean Water Act § 1365, Clean Air Act § 7604, SDWA § 300j-8(a)(1), SMCRA § 1270, TSCA § 2619.

45. The Canadian Environmental Protection Act, 1999, S.C. 1999 c. 33.

46. Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests. (*OJ L 166, 11.6.1998, p. 51–55*)

this right in relation to environmental protection.⁴⁷

Given the nature of the affected public interest, the European Coalition for Corporate Justice believes that reform of parent company liability should ensure private enforcement of public liability.⁴⁸ Access to such enforcement should be granted to persons who have a sufficient interest or maintain an impairment of right, such as affected non-governmental organisations and victims of abuse.

47. The UNECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters, usually known as the Aarhus Convention, that was ratified by the EU and most of the Member States. It obliges its Parties to enable the affected public, expressly including NGOs, access to justice against a state's decisions in environmental matters (Article 9.2), and against private persons (Article 9.3). However, formulation of Article 9.3 is very vague and most of the Parties have not implemented this provision. Failure of implementation was criticised by the Aarhus Compliance Committee at its 8th meeting, which took place in May 2005 in Alma Aty, Kazakhstan. At the European level, Article 9.3 should have been implemented by proposal for a Directive of the European Parliament and of the Council on access to justice in environmental matters [COM(2003) 624]. However, the legislative process in respect of this proposal eventually stalled

48. Those who are affected by the negative impacts will be more motivated to seek justice. For example criminal proceedings in the French case of *Total/Erika* were brought by private parties – environmental organisations, municipalities, and individual victims.

Proposal 2: Enhancing Duty of Care

2.1 Overview

There are a number of situations where MNEs can decisively influence operations of other legal persons that are not formally part of the company group, but are economically dependent on the group. Most prominently, but not exclusively, this entails two types of relationships:

a. Joint Ventures

Joint ventures consist of two or more corporations. In the mineral extraction sector, these joint ventures are often government led, where corporations are generally responsible for financial and technical aspects of the project, while governments often hold the responsibility for environmental and human rights compliance. Examples of such cases include the Kazakhstan's Karachanagak Petroleum Operation⁴⁹ and the Yadana Pipeline Project in Burma.⁵⁰

49. In this case the citizens of Berezovka municipality and the non-governmental organisation Green Salvation criticise KPO for reducing the “Sanitary Protection Zone” surrounding the KPO facility and thus exposing local communities to emissions from the facility without right to compensation. For more details see: <http://www.greensalvation.org/en/index.php?page=berezovka-en>

50. The Yadana project is surrounded by controversies regarding relocation and alleged extermination of the inhabitants “standing in the way” of the project and use of forced labour by the Myanmar government that cooperates with Total in the project. See: http://www.burmacampaign.org.uk/total_report.html , Total's point of view is presented at: <http://burma.total.com/>

b. Supplier Relations

In order to increase flexibility and minimise economic risks, it is common, particularly within the consumer goods sector, for MNEs to outsource manufacturing yet retain responsibility for research, development and strategic control of the enterprise. MNEs generally dictate conditions to these suppliers that often determine the environmental and labour conditions of the production of goods, yet liability for these environmental and labour conditions falls outside the scope of legal liability of the MNE.⁵¹

Under existing European law,⁵² the duty of care of the parent company with respect to the affiliate's operations is limited to specific situations where the parent is directly involved in the operations or

51. For example, child labour in Andhra Pradesh, India in relation to the production of cottonseed for companies, including the German-based pharmaceutical company, Bayer. In 2003, 2004 and 2006 researchers found that children were working shifts of up to 14 hours a day, earning less than 50 (US) cents a day and suffering serious injuries due to pesticide exposure working for farmers that supplied Bayer's Indian subsidiary ProAgro. Most of the children worked under “debt contracts” and some were even living in outright slavery. Source: OECD (2008) Watch Quarterly Case Update, vol. 3 iss. 1, p. 12, available at: http://www.oecdwatch.org/docs/OW_Quarterly_Case_Update_Spring_2008.pdf. Another example is the toxic poisoning of workers at Hivac, Motorola's supplier, that had been using n-hexane, a highly toxic substance, to wash and scrub acrylic screens for mobile phones. The workers were working in poorly ventilated workshops and were not provided with face masks or training in handling the dangerous chemical. When local labour support groups raised the issues of hazardous working conditions and compensation for the poisoned workers, Motorola claimed that the issues had been resolved, but workers reported only superficial changes. For example, the hazardous n-hexane was replaced with equally dangerous “lacquer thinner” containing benzene. Furthermore, the faulty ventilation system in the factory was replaced, but was still rarely turned on because the increased flow of air dries out the paint and forces the company to spend more on materials. Source: SOMO (2006) “*The High Cost of Calling: Critical Issues in the Mobile Phone Industry*”.

52. See notes 13, 14.

is driving the affiliate's decisions.

There is an apparent risk here for MNEs wishing to improve their supply chain management: the greater the involvement of the MNE in the supplier's operations (in terms of knowledge and control) the greater the risk that direct liability for the consequence of those operations may be incurred under existing legal principles. Certain MNEs operating in brand sensitive sectors have nonetheless improved their supply chain management,⁵³ but others may have been deterred from doing so.

Furthermore, the ability of victims to obtain any redress from the parent is severely limited, as it is very difficult for claimants to produce the necessary evidence of knowledge and control – such evidence is generally in the possession of the corporations themselves. In cases with an extraterritorial element, redress is even harder as courts may refuse to accept jurisdiction over the matter. Consequently, cases where the parent has been held liable have been rare.⁵⁴

53. For example, global sportswear giant, Nike, which first disclosed its factory locations two years ago, reports that the company is “seeing successes as a result of collaboration – shared information, shared best practices, leveraged resources and more effective coverage of supply chains within our industry”. They add that so far “we have realised no competitive disadvantage from bringing greater transparency to our supply chain”. However, even “frontrunners” in CSR reporting like Nike have been criticised for not disclosing enough about how the shifts in their production sourcing strategies and how their buying practices impact workers, communities and even countries. And while some companies, such as Gap, have taken steps forward in reporting on their understanding of the root causes of non-compliance with labour standards, more transparency is needed on what is actually being done to solve those problems. Source: Maquila Solidarity Network “*The Next Generation of CSR Reporting: Will Better Reporting Result in Better Working Conditions*”, December 2007.

54. Zerk, See note 40

The European Coalition for Corporate Justice proposes the recognition of a legal duty of care on the part of a company to ensure that human rights and the environment are respected throughout its sphere of responsibility. A company should be held legally liable if it cannot demonstrate that it has complied with this duty. Thus, a duty of care would be extended to all situations where a company is able to exercise significant influence over the operations of another entity that may have an adverse impact upon human rights or the environment. This duty of care should entail two basic principles:

1. An obligation to investigate the risks of human rights and environmental abuses within the company's sphere of responsibility; and
2. An obligation to take all reasonable steps to prevent and mitigate human rights or environmental abuses where such risks have been or should have been identified.

This chapter provides an overview of the legal text which could be used to introduce a new duty of care into European law; provides an overview of key legal questions arising from the proposal; makes proposals in relation to improving directors' duties'; and proposes reforms to tortious/civil and criminal liability to ensure effective enforceability.

2.2 Legal Text

The following legal text summarises the core of the second European Coalition for Corporate

Justice proposal. This legal text is not intended to provide definite language, but defines the proposal as a high level principle to be implemented in European law and the laws of the Member States.

1. An undertaking shall adopt all reasonable steps to prevent or mitigate human rights and environmental abuses within its sphere of responsibility. An undertaking shall be relieved from this duty if it can prove that, exercising reasonable care, it could not reasonably have known about the abuses in question.

2. In the event that an undertaking fails to meet the requirements of this clause, it shall be liable for any consequential non-contractual losses, damages, costs and expenses arising out of personal injury or environmental damage or damage to property caused by the other legal persons belonging to the undertakings' sphere of responsibility.

Any person who has suffered damage for which an undertaking is liable under this clause shall be entitled to bring proceedings in the courts of any Member State where a relevant undertaking is located or has substantial operations.

3. A relevant undertaking shall be liable for effective, proportionate and dissuasive sanctions in any case in which its failure to adopt all reasonable steps significantly contributes to the abuse of human rights and environmental standards expressed in - international conventions listed in Annex III of the EU Generalised System of Preferences.

Members of the public in the state in which proceedings are to be brought and any other person who is or may be affected by the conduct complained of, shall have access to judicial procedures to challenge such abuses and to require imposition of sanctions.

4. These provisions apply whether the conduct complained of takes place inside or outside the European Union

5. The authority to determine the liability of an undertaking under this clause shall fall in the jurisdiction of:

(i) The courts and public authorities of the Member State, where the undertaking is incorporated; or

(ii) In the event that the undertaking is not incorporated in any of the Member States, the courts and public authorities of any Member State in which territory an undertaking has a substantial operation.

Appointed courts and public authorities may decline jurisdiction only where:

(i) In private matters, proceedings in respect of the same cause of action have been commenced in another jurisdiction and such a claim has a reasonable prospect of being heard in a timely and fair process which is not prejudicial to the human rights of the claimant.

(ii) In public matters, proceeding in which sanctions may be imposed on the undertaking for the same default have been commenced in another Member State.

6. The undertaking's liability shall be determined

in accordance with the laws of the forum. This shall not require a foreign undertaking to be treated as if it were subject to the public law regulations of the forum.

7. Nothing in this clause shall relieve the subsidiary undertaking from any liability.

2.3 Further Legal Questions

This proposal would have analogous implications in civil and public liability, as have been identified in Chapter 1 regarding strict parent company liability. There are, however, several additional legal questions arising from an imposition of a new duty of care. The following are of central relevance:

1. How would a company's sphere of responsibility be defined?
2. What would be the extent of the company's duty to know about the risks of human rights and environmental violations within its sphere of responsibility? What would constitute a failure of the duty to take all reasonable steps to prevent violations?

Outlined below is a summary of how the European Coalition for Corporate Justice believes these issues can be addressed.

2.3.1 Defining Sphere of Responsibility

Sphere of responsibility is a narrower concept than that of "sphere of influence".⁵⁵ Although the

55. Sphere of influence has become an analytical tool for delimiting the corporate voluntary responsibilities since the UN Global Compact (UNGP) introduced the term. Most prominent in this sense is work of the Business Leaders

latter can be taken into account, the notion of influence is itself too extensive to provide a basis for a company's legal responsibility for human rights abuses.⁵⁶ It is extremely difficult to provide an exhaustive definition of sphere of responsibility. However, building on the work of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises (SRSG),⁵⁷ factors of control, causation and benefit and the duration and severity of the human rights impact should be taken into account when assigning the responsibility. In defining the responsibility the following should be considered:

- Any control exercised through contractual relationships;
- The ownership of the entity (including minority interests);
- Any overlap of staff within the company's management;
- Purchasing a high percentage of the supplier's output;

Initiative on Human Rights (BLIHR). See *A Guide for Integrating Human Rights into Business Management* (BLIHR, UNGP and Office of the High Commissioner for Human Rights (OHCHR) available at: <http://www.ohchr.org/Documents/Publications/GuideHRBusinessen.pdf>, or *Understanding Sphere of Influence and Complicity* (OHCHR) available at: http://www.unglobalcompact.org/Issues/human_rights/gc_and_human_rights.pdf.

56. Two members of the SRSG's team recently tried to clarify the concept of corporate sphere of influence. They argued that the concept as previously articulated lumped together too many disparate concepts, such as control, causation, physical proximity, benefit, and political influence, and thus was unable to provide crisp policy guidance to companies and stakeholders. See Amy Lehr and Beth Jenkins "Business and human rights – Beyond corporate spheres of influence", 12 Nov 2007 available at <http://www.ethicalcorp.com/content.asp?ContentID=5504>.

57. The report from the SRSG's multistakeholder meetings held in 2007: Corporate Responsibility to Respect Human Rights Geneva, 4-5 Dec., 2007, Ruggie, J., available at: <http://www.reports-and-materials.org/Ruggie-Geneva-4-5-Dec-2007.pdf>.

- Benefiting directly from the violations committed by others;
- Providing significant amount of finance.

It is not possible to give an exhaustive list of what should constitute sphere of responsibility under all circumstances; courts will need to make their own judgments based on case specific considerations.

2.3.2 A Company's Duty to Know and Take Reasonable Steps

A company's duty would vary depending on the degree of influence a particular company had over the person committing the abuse or, in an appropriate case, over the operation itself. A 'one size fits all' approach to defining the scope of a company's obligations is not realistic due to the complexity and range of issues that would need to be considered in each individual case. It is however possible to identify certain factors that would indicate a failure to meet this duty. The European Coalition for Corporate Justice believes that these indicators should include:

1. Where the company controls a significant amount of shares, or possesses some other form of voting rights in the wrongdoing subject and fails to exercise those rights;
2. Where the company has either a direct or indirect contractual relationship with the wrongdoer and is in an economically dominant position, and abused that position or imposed terms effectively requiring the subject to commit the abuse (e.g. a dominant purchaser insisting upon a low selling price that the supplier can only meet by implementing abusive labour practices);

or

3. Where the company is in breach of any public, but voluntary, Corporate Social Responsibility (CSR) commitment with regard to supply chain management.⁵⁸

2.4 Directors' Duties

This duty of care would be further enhanced by imposing directors to exercise reasonable care in their management and control of the company to ensure that the company itself complies with the extended duty of care, in particular to ensure that the company has proper internal systems to address relevant environmental and human rights issues. The European Coalition for Corporate Justice proposes that directors should be liable themselves to exercise a duty to take reasonable care to ensure that the parent company adequately identifies and responds to the risks of human rights and environmental abuses in an MNE's operations. Unlike the directors' duties set out in proposal 1, this duty of care would be strict as the parent company's own compliance is within its (and hence the directors') own control and does not depend upon the activity of other legal persons.

As with the strict parental liability proposal, the

58. Liability based on failing CSR duty has been recently recognised in the French case *Total/Erika*. Total's CSR policy included procedure called "vetting" - inspection of tankers to be used for the company. The Erika was vetted for the last time a year before the disaster, and had been 'authorised' only for one year given the bad shape of the ship. Disaster happened few weeks after expiration of vetting consent. In the end Court held Total liable for knowing that the Erika was not in good shape, not only for failing to realise its CSR commitment, but it clearly made a step in the direction of recognising legal consequences of voluntary corporate commitments.

directors' duties here would be not only to the company. The failure to comply with such obligations should be punishable by public sanctions. Additional to public bodies, *locus standi* would be granted to other properly interested persons, such as certain non-governmental organisations protecting the affected public interests.

2.5 Methods of Enforcement

Reform of the law as set out above should in itself lead to a reduction in cases of corporate abuse. However, in the event that abuses would nevertheless occur, further reform (as described in Section 1.5 in respect of proposal 1) would be required to ensure proper enforcement of the obligation. Thus the duty of care could be enforced through civil claims brought by those who had suffered damage, and public liability enforced by the state, or by interested parties.

Proposal 3: Mandatory Environmental and Social Reporting

3.1 Overview

The two previous proposals seek to reduce the adverse environmental and human rights impacts of MNEs by making them directly accountable to victims of their activities and to other interested parties. To enhance and complement these reforms, the European Coalition for Corporate Justice proposes that MNEs should be obliged to conduct proper environmental and social reporting (ESR). This will improve MNEs' transparency and assist those seeking to hold them accountable for breaches of their primary obligations.

ESR is widely used as a voluntary tool by MNEs as part of their stated commitment to CSR. But despite attempts by various platforms to establish common reporting standards,⁵⁹ the reports produced by companies contain environmental and social data that is at best difficult, at worst virtually impossible, to compare. Information is provided selectively, often ignoring the worst environmental and human rights impacts associated with the reporting company, and

59. A few voluntary initiatives, most notably the Global Reporting Initiative (GRI), have attempted to provide a common reporting standard, but ambiguous wording and a lack of enforcement mechanisms beg questioning of the ability of these standards ever to be coherently used by all relevant businesses. An article in the Ethical Corporation Magazine covering discussion between Mallen Baker, who thinks GRI is failing, and Andy Savitz, who says it's still on track, highlights the controversy. The article is available at: <http://www.ethicalcorp.com/content.asp?ContentID=5755&newsletter=24>.

focusing instead on less controversial topics.⁶⁰ This has undermined any prospect of a level playing field for MNEs in respect of their CSR performance.

Furthermore, it is very difficult to hold companies to account for any inaccuracies in their reports. Directive 2005/29/EC on Unfair Commercial Practices⁶¹ does prohibit companies misleading consumers and entitles consumer organisations to seek injunctions for such behaviour, although in practical challenges to seeking any legal remedies through this directive remain.⁶²

60. For example, the German pharmaceutical company Bayer, whose problems with benefiting from children labour were described above (note 51) highlighted in its 2005 "Sustainable Development Report" only some of the company's activities in India without clearly indicating the child labour problem that NGO campaigns had exposed. The 2006 report referred to NGO campaigns and mentioned Bayer's reaction. However, the NGOs involved challenge the content of the claims made in the report. Joseph Wilde-Ramsing, who co-authored SOMO's 2006 research report on conditions in mobile phone supply chains, describes a similar lack of transparency with regard to supply chain in the case of Finnish mobile phone producer Nokia: "When we raised questions with Nokia about labour practices and the degree of their relationship with a Thai supplier we were told that this information was confidential and commercially sensitive. Neither Nokia's Annual Report nor its Corporate Responsibility report provide information on its suppliers and contain only very limited information on the working and environmental conditions at factories supplying components for Nokia phones. Often, workers at suppliers such as this Thai factory don't even know which brand company they are producing for and therefore are deprived of critical information to try to have those in a position of authority address rights infringements. Nokia's claims to protect workers' rights are thus rendered meaningless when the workers themselves are unable to access such protection."

61. Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive'). (OJ L 149/22, 11.6.2005, p. 22-39)

62. These challenges include: (a) It applies only in respect of information that may influence economic behaviour of the consumers. This rules out any applicability of this legislation to some sectors entirely and in the sectors that are covered, it applies only to human rights and environmental information that can be proved to have had an impact on consumers. (b)

European law has already taken steps towards compulsory ESR through the Accounts Modernisation Directive.⁶³ Under this Directive, Member States are required to ensure that companies produce an annual report of their financial position that includes an analysis of: “...where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.”⁶⁴ However, this obligation is based on a shareholder-oriented duty to report on financial risks. Risks or negative impacts in the environmental or human rights spheres of company's operations that are not considered of material interest to the company do not need to be considered.⁶⁵

Several national jurisdictions have gone further and pioneered mandatory ESR, including Denmark, The Netherlands, Sweden, Norway and France.⁶⁶ They differ in scope and detail, but

Lack of consistent reporting standards allows companies to present information in a very misleading way even though it may not be factually inaccurate. This practice is very difficult to legally contest. (c) The directive doesn't provide for direct deterrent sanctions that could be applied against the wrongdoing company. The effectiveness of the regulation relies on the companies' brand sensitiveness.

63. Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. (OJ L 178, 17.7.2003, p. 16–22)

64. See Article 46 of Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, and Article 36 of Seventh Directive. (OJ L 222, 14.8.1978, p. 11–31)

65. The rationale for this kind of reporting is so called *enlightened shareholder value*, similar to what the failed British *Operational Financial Review* was to be based on. The drawback of this approach is ambiguity of what should be considered as material to shareholder interests.

66. Danish 1995 Green Accounts (Environmental Protection

available research indicates that regulation was, in general, perceived as a positive step by businesses to improve effective environmental and human rights performance.⁶⁷ However, the efficiency of these schemes has been diluted due to a general lack of clear duties, enforcement mechanisms and detailed rules on the content of the reports.⁶⁸

Act as amended in June 14 1995 by Act No. 403, and statutory order No. 975, of December 15, 1995), Dutch Environmental Management Act (EMA) as amended on 10 April 1997, Norwegian 1998 Accounting Act (Regnskapsloven, LOV-1998-07-17-56), Swedish Accounting Act amended in 1999 (Law of Accounts (1995:1554), French New economy regulations (Loi relative aux nouvelles régulations économiques n°2001-420 du 15/05/2001 as implemented by Decree 2002-221).

67. The Danish Environmental Protection Agency has conducted a survey of efficiency and impact on 550 Danish companies. According to the survey, 41% of companies believed they had achieved environmental improvements through green accounting. Among these 70% emphasised energy, 50% highlighted water and waste, 40% consumption of resources, 30% wastewater and additives, 20% reduced emissions into the air and 10% emissions into the soil. Further, *'About half the companies preparing green accounts report gain economic benefits from their work with the accounts. Most companies taking part in the evaluation could not give actual figures for their savings and revenues. But approximately 25% having experienced economic benefits and quantified them, had on average saved 75,000 DKK (approx. Euro 10,000), and a quarter of these saved more than 250,000 DKK (approx. Euro 35,000).'*” A French study *Critical Review [Critical Review of How Companies Are Applying French Legislation on Social and Environmental Reporting, Observatoire sur la Responsabilité Sociétale des Entreprises (ORSE), Oreé, Entreprises pour l'Environnement (EpE), 2003]* has also reported rather positive or at least indifferent reaction from business, although it does not provide exact statistics. According to Bubna-Litic, who compared results of the Australian government evaluation of ESR before and after mandating it [*Bubna-Litic, Karen: Mandatory corporate environmental reporting: does it really work?, 2004*]: “ *In 2002, individual companies' self-introduced severity ratings were, as in 1999, one of the most valuable items of information. There also appears to be a trend towards companies developing environmental risk-management strategies. The increased reporting by the banks was an encouraging result. ... One of the most encouraging findings of this second report is the reporting by companies of the focus on environmental matters at board level, specifically through audit and compliance committees of the board.*”

68. According to the report by the Centre for Development and the Environment at the University of Oslo (*Vornedal, Irja and Ruud, A 2008. "Sustainability Reporting in Norway – an Assessment of Performance in the Context of Legal Demands and Socio-Political Drivers". Business Strategy and the Environment, Wiley InterScience*), while almost all the 100 largest Norwegian companies mentioned the three areas required under the Norwegian Act (the external

Compulsory ESR accompanied by effective enforcement mechanisms will ensure that MNEs report on what is important with respect to their impact on human rights and the environment and that the information contained within the report is accurate, comprehensive and comparable. This obligation will encourage MNEs and their officers to set up appropriate management mechanisms and to actively seek to prevent abuses. Furthermore, in cases where a particular corporation is said to have breached its duty of due care, the contents of public reports would ease the burden of proof on the plaintiffs in respect both of the corporation's knowledge of the likelihood of abuse and what steps were taken to prevent it. ESR duties would not provide victims with direct claims against the MNE but if well engineered, would increase the transparency of the social and environmental impacts of MNEs' activities.

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environment, health and safety of employees and gender equality) in their annual reports, the vast majority of the companies failed to meet the requirements under the law for disclosure. The French regulation, as highlighted by the authors of *Critical Review*, provides for relatively detailed rules on the content of the reports, at least in respect of social and employment questions, but was criticised for the lack of clarity in respect of the scope of the duty to report on a company's subsidiaries and foreign operations and for the lack of rules on the presentation of the data and for missing enforcement mechanisms. In Australia, according to *Bubna-Litic*: "[i]t can be concluded that many companies, mindful of misinterpreting their obligations, are including only the most minimal of comment, which may be well short of details that could be considered useful to stakeholders. The 1999 report concluded that references to regulations and licences are too general to be useful and that what is necessary is the effect that such regulations and licences have on a company's activities. Stakeholders also need to be satisfied of a company's risk management, its positive environmental initiatives and, if there were breaches, how they have been assessed, by whom and how they have been rectified. The 2002 study has found that more companies are tending to emphasise the positive and are focusing less on the negative, which is a change in direction from the 1999 report."

believes effective ESR should include reporting on the following elements:

1. The enterprise structure and its sphere of responsibility;
2. The risks of human rights and environmental abuses within the enterprise's operations or the operations within its sphere of responsibility, and the measures adopted to prevent those abuses;
3. Data on direct and indirect social and environmental impacts of the operations of the MNE's in the preceding reporting period according to a specified set of performance indicators.

Existing ESR tools have emphasised performance indicators (point 3 above). The European Coalition for Corporate Justice believes issues in relation to an MNE's sphere of responsibility and the risks facing its operations are also fundamental as these have the potential to identify that the MNE is itself responsible for any relevant human rights and environmental abuses.

3.2 Legal Text

The following legal text summarises the core of the third European Coalition for Corporate Justice proposal. This legal text is not intended to provide definite language, but defines the proposal as a high level principle to be implemented in European law and the laws of the Member States.

1. *Undertakings other than small and medium enterprises shall prepare a consolidated annual environmental and social report (ESR). The*

consolidated annual ESR shall:

(i) Identify subsidiary undertakings that are controlled by the undertaking, and other persons or organisations, including state agencies, that fall, based on financial, contractual or similar relationships, in the sphere of responsibility of the undertaking, together with a description of the nature and extent of such relationships.

(ii) Include an analysis of the risks of human rights and environmental abuses, as expressed in international conventions listed in Annex III of the EU Generalised System of Preferences, facing the undertaking's operations or its sphere of responsibility and the description of steps taken by the undertaking to prevent and eliminate the identified risks.

(iii) Set out such key indicators of the undertaking and its subsidiaries' performance as may be specified by the Commission.

2. The Commission shall make regulations for the presentation and audit of the ESR. Such regulations shall require that:

(i) data shall be collected and presented broken down to characteristic categories of activities and by specific geographical locations. That is, they shall be presented on a per-country and, where appropriate, on a per-activity basis.

(ii) The data shall be provided in historical comparison.

3. The reports shall clearly indicate the calculation methods used for the data, including estimates or assumptions and third party sources of information.

4. In the event the undertaking fails to accurately report information required by this clause, it shall

be liable for effective, proportionate and dissuasive sanctions.

Members of the public shall have access to judicial procedures to challenge such failures and to require the imposition of sanctions.

3.3 Further Legal Questions

This proposal would have analogous implication in the area of public liability as has been identified for the parent liability approach presented in proposals 1 and 2; it also supplements the civil liability provided for in proposal 2. There are several additional legal questions, however, arising from such a reporting obligation. Of central relevance are:

1. Who should be subject to the reporting duty?

2. What categories of data should be disclosed?

3.3.1 Those Subject to the Reporting Duty

The obligation to report shall be carried out by companies as legal persons – analogously to financial reporting obligations. It is of most relevance to large enterprises, as they are more likely to affect human rights and environment related issues, therefore SMEs (Small and Medium Sized Enterprises) would be excluded from this obligation.⁶⁹ This approach is consistent

69. The definition of Small and Medium Enterprises is again derived from existing accounting rules in the Seventh Directive and Fourth Directive, where it is based on annual turnover and number of employees. However, in certain cases this protection might be lifted, for example, if the enterprise operates or owns certain facilities or conducts specific activities that are sanctioned by European environmental law, or if the shares of that enterprise are traded on European stock exchanges. The latter option is important for socially responsible investors and forms the basis of the French mandatory reporting regulation.

with the Fourth and Seventh Company Directives. However, SMEs could be encouraged (by fiscal or other incentives) to comply with the reporting guidelines on a voluntary basis.

In order to ensure that the ESR regulation meets its envisaged aim of establishing a level playing field and increasing transparency of business operations connected to the European market, the ESR would not be limited to MNEs whose parent companies are established within the EU but also to foreign MNEs that have substantial operations in the EU, whether through sales into the EU, or stock exchange listings or through the presence (or operations) of subsidiaries. However, a prescriptive EU measure that would directly extend to persons incorporated outside the Union would run into the same problems of extraterritoriality and enforcement as were discussed in relation to the other proposals. In order to address this, the European Coalition for Corporate Justice proposes that subsidiaries of foreign MNEs established or operating in the EU would have to disclose information about the whole corporate group they belong to, regardless of their position in the group.

3.3.2 Category of Data to be Disclosed

The European Coalition for Corporate Justice believes that enterprises should be made to report on their operations worldwide regardless of territorial boundaries (as is the case for financial reporting). This data would be broken down on a per-country and per-operation basis to enable a comprehensive overview of the enterprise's impact. In order to ensure quality and comparable reporting, it would also be necessary to develop specific sets of concrete and unambiguous

indicators that would be tailored for each business sector. Existing initiatives such as the GRI and Accountability AA1000 standards⁷⁰ provide a useful basis. The categories of data to be disclosed should extend beyond mere environmental and social indicators and should include ethical indicators that could additionally undermine the environmental and social performance of the MNE. In this respect the disclosed data should include:

1. Financial data not reported under existing financial reporting systems in relation to corporate relations with state authorities.⁷¹
2. Information in relation to any cases of exemptions awarded to the company in relation to public interest laws.⁷²
3. Information in relation to any non-compliance with applicable laws and standards.
4. Details of investment agreements with public authorities insofar as they impact upon human rights and environmental issues, or constrain states regulatory powers in these areas.

70. See www.globalreporting.org and <http://www.accountability21.net/default.aspx?id=122> . See also note 50.

71. The Publish What You Pay coalition (PPP) (<http://www.publishwhatyoupay.org/>) of over 300 NGOs worldwide calls for the mandatory disclosure of the payments made by oil, gas and mining companies to all governments for the extraction of natural resources in order to increase accountability in using the revenues from this sector of industry. Under these terms the coalition has developed a list of information needed that is not required to be reported under international accounting standards. The 2005 PPP Submission to IASB which include this list, is available at: <http://www.taxresearch.org.uk/documents/ias14final.pdf>.

72. Seeking exemptions is a potentially dangerous practice that undermines the rule of law and generally the protection of public interest generally. Article II.4 of the OECD guidelines states that Enterprises should: “Refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation, financial incentives, or other issues.”

5. Information about arbitrary processes that concern human rights or other public interests.⁷³

3.4 Directors' Duties

The European Coalition for Corporate Justice believes that it is crucial to ensure that directors have a duty to ensure that an effective working system is set up within the company to address its reporting obligations. Such an obligation would be absolute. A failure to comply with this obligation would be punishable by public sanctions. Additional to public bodies, *locus standi* would be granted to other properly interested persons, such as certain non-governmental organisations protecting the affected public interests.

3.5 Methods of Enforcement

Legislative introduction of ESR should encourage companies to put systems in place that will lead to a reduction in corporate abuse, due to the increased transparency of business operations and the commercial forces this would stimulate. If a company does not properly observe these reporting standards the company and where appropriate, its directors, should be subject to appropriate sanctions.

The outstanding issue regarding enforcement is

what should be the role of verification or auditing mechanisms. The reports would require independent verification. However, information about the sphere of responsibility and risk assessment could be very complex and hard to assess. Enforcement would ultimately rely on prosecuting the company and its directors where a breach of the reporting obligation became apparent following a demonstrable case of abuse.

Due to the relevance of this information to such a wide range of stakeholders, *locus standi* should be granted to specialised public bodies and also to private persons having a sufficient interest or maintaining an impairment of right, such as certain non-governmental organisations and victims of abuse.

73. The lack of necessary transparency in respect of the investment treaties and the outcomes of arbitration proceedings has been noted in SRSG's report, points, 36, 37 (*Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, April 2008*)

Conclusion

While Europe has been transformed through changes in the law in relation to its geographic scope, economic frameworks and democratic processes, the basic structure of MNEs has not, resulting in a significant gap in their accountability to society as a whole. The European Parliament has stated the need to strengthen corporate accountability mechanisms within Europe, yet at present there is no clear process in place to make this happen. Although European involvement in CSR initiatives continues to be prioritised, the development of effective accountability mechanisms often feels beyond Europe's reach. However, as this report shows, there are significant improvements that could be made through changes in European law which would improve accountability mechanisms and thereby contribute to the improved behaviour of MNEs internationally.

These proposed reforms show that through the recognition of MNEs as a single entity in law the actual responsibility of MNEs could be effectively acknowledged, resulting in a much more coherent approach to European measures designed to ensure the ethical behaviour of MNEs. The proposal to introduce a duty of care on MNEs demonstrates the possibility of creating a level playing field for all MNEs in this arena – even joint ventures and complex supply chain relationships. Imposing disclosure obligations on MNEs would also promote this level playing field in respect of CSR performance through the introduction of coherent reporting standards and the introduction of punitive measures for

reporting false information.

In order to effectively implement these new proposals, the European Coalition for Corporate Justice recognises the importance of effective accountability mechanisms within the company and to the company. Additional proposals are therefore made in relation to directors' duties, including new obligations covering environmental and human rights impacts; and the introduction of legislation allowing international victims of environmental and human rights violations to claim damages from MNEs.

There is no silver bullet to stop MNEs profiting at the expense of people and the environment and solutions must be found in a range of arenas. However, the proposals in this report, if introduced, would go some way to overcoming some of the fundamental accountability gaps of MNEs within Europe today. The European Coalition for Corporate Justice looks forward to working with all European stakeholders including governments, businesses and civil society in constructive dialogue to formulate and implement effective solutions to ensure corporate justice.