

PRINCIPLES & PATHWAYS:

LEGAL OPPORTUNITIES TO IMPROVE
EUROPE'S CORPORATE
ACCOUNTABILITY FRAMEWORK





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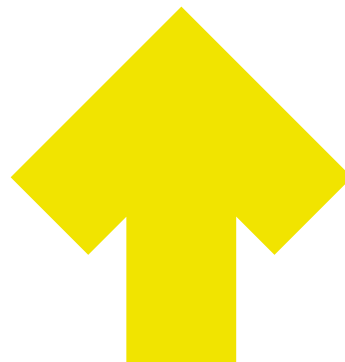
✦ WRITTEN BY:

Filip Gregor, The Environmental Law Service

✦ SPECIAL THANKS TO:

Hannah Ellis, The Corporate Responsibility (CORE) Coalition

Marie-Caroline Caillet, L'association Sherpa



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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 legal framework for EU hosted corporations to protect people and the environment. The European Coalition for Corporate Justice's membership includes more than 250 civil society organisations in 15 European countries. This growing network of national-level coalitions includes several Oxfam affiliates, national chapters of Amnesty International, Greenpeace, Friends of the Earth, The Environmental Law Service, Forum Citoyen pour la RSE, The Corporate Responsibility (CORE) Coalition, The Dutch CSR Platform, and La Fédération Internationale des Droits de l'Homme (FIDH).

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FOREWORD BY
RICHARD HOWITT MEP



European companies are central to the success of the European Union. Yet some companies are far too often associated with violations of workers' rights, environmental damage and harm to local communities. These range from European involvement in the illegal dumping of highly toxic chemical in the Ivory Coast poisoning 30,000 people, or the clothes on our high streets across Europe being made by the use of child labour in Bangladesh and India. Whether in Europe or causing harm abroad, the European Union can no longer afford to be complicit in what are violations of human rights.

The European Union has already played a critical role in the development of voluntary initiatives to deal with these challenges in our work on corporate social responsibility. However, the existing regulatory framework for European companies does not fully meet the challenge of corporate accountability in the era of globalisation, as my resolutions on corporate responsibility on behalf of the European Parliament articulate. A recent study produced by the European Commission also underlines these gaps in existing legal frameworks. This innovative research clearly demonstrates how such gaps can be addressed in a practical and concrete way. Amendments to laws governing environmental and social reporting, and access to the European courts for victims, would be an important step forward.

This debate has been fundamentally altered by the outstanding work of the United Nations Special Representative on Business and Human Rights, Professor John Ruggie, in whose consultations I have been proud to participate on behalf of the European Parliament. Professor Ruggie's 'smart mix' combining regulation and voluntary action has been fully endorsed by the United Nations Human Rights Council, by the European Union and by business itself.

This report, produced by the European Coalition for Corporate Justice, is a very welcome initiative, further detailing practical suggestions on how to improve the reputation and impact of European companies and galvanising momentum for long term and much needed change.

Richard Howitt MEP

European Parliament Rapporteur on Corporate Social Responsibility

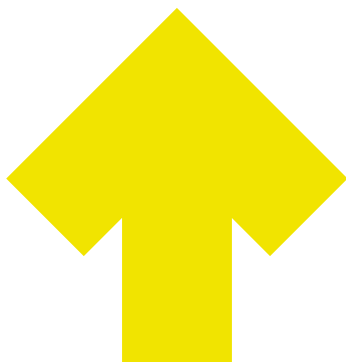


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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

The European Union ('EU') prides itself on promoting Europe's economy alongside protecting her environment and caring for her people. Since the Treaty of Rome, Europe has expanded in size, and sphere of influence. The EU's legal capacity has put it in an exceptional position to create and implement some of the best environmental and human rights laws internationally, yet the Multinational Enterprises ('MNE') it hosts have continually and increasingly been associated with gross environmental and human rights violations within the EU and internationally, documented by civil society groups, academia and the EU itself. The reason for these continued violations of rights is complex and multifaceted, yet of central significance is the European law that governs these MNEs' legal structure and accountability.

There is much the EU could do to reform these legal structures and accountability mechanisms. Part I of this report highlights what changes to the EU's corporate reporting framework, coupled with amendments to the rules governing legal actions before a court, would significantly improve the accountability of EU hosted MNEs. In relation to corporate reporting, the ongoing review of EU legislation on corporate reporting offers a timely opportunity. This report suggests the EU introduce reforms to ensure more transparency by MNEs. It proposes that this be attained by introducing legal requirements for MNEs to report on the impacts of their operations both in the EU and internationally, with the mandatory introduction of clear, audited, comparable and enforceable standards for large and medium-sized companies. Greater transparency by reforming reporting requirements can help to establish human rights and environmental protection as core business concerns.

Part I also considers changes to private international law that would result in improvements for third-country victims of MNEs to access a remedy. Specifically, the proposals address law defining the competence of Member State courts to adjudicate private law disputes with a foreign element, and the determination of applicable law in relation to such disputes. These rules are central to any review of the effectiveness of existing legal frameworks governing remedy of violations caused by companies operating outside the EU. The report acknowledges the role of Brussels I Regulation in enabling third-country victims of corporate human rights and environmental abuses to sue corporations in a Member State. It makes suggestions as to how this regulation could be improved through reforms enabling claimants to sue a subsidiary domiciled in a third country together with the EU based parent corporation and through the creation of additional grounds of jurisdiction, including *forum necessitates*. The report also considers the role of Rome II Regulation, in determining applicable law. It suggests how this regulation could be reformed to ensure that manifest breaches of human rights are never excused.

However, the report also recognises that in themselves, these reforms will prove insufficient to address the scale of the challenge. A comprehensive, long term, sustainable, legal and enforceable system for corporate accountability needs to be built. Companies have a unique legal structure that all too often provides them with a legal shield against being held to account for environmental and social harm. Separate legal personality, limited liability for shareholders and the ability for the company itself to become a shareholder in other companies – insulate each legal unit of the MNE, including the parent company, from obligations of other members of the economic group, that often operate in third countries. In addition to the legal obstacles to accountability which this structure dictates, people whose rights have been abused by MNEs face overwhelming procedural and material obstacles to access justice. These dysfunctionalities are exacerbated and denial of justice is likely where the judicial system of the country in which the MNE carries out the operation that violates human rights or the environment is undermined by societal factors - corruption, lack of political will or lack of institutional capacity. This occurs regularly in developing countries, where MNEs increasingly concentrate their production.

Part II of the report therefore outlines systemic legal reforms to address the scale of the challenge. In summary, these entail:

1. Improving the governance in the operations of MNEs concerning foreign subsidiaries and sub-contractors.

The report proposes that parent companies be required by law to exercise oversight and control of their subsidiaries and business partners in third countries in regard of their compliance with the international standards of human rights and protection of the environment. This would reflect the distribution of decision-making powers within MNE and would enable victims from third countries to bring civil claims before the courts in the EU were they unable to access justice in their own State. On the basis of general legal principles common to all Member States such responsibility already exists. However, because its standards are not clarified it is too risky for victims to try to hold parent companies accountable before courts of Member States. It follows that it would be desirable to harmonise these standards using EU law.

2. Improving disclosure of information.

The EU legislation should provide people with the right to access the information that is held by companies and that is required for the exercise or protection of their rights. The principle of mandatory reporting of non-financial data is already recognised in EU law, however, this lacks clarity and effective enforcement, and does not provide victims with legal standing to request the withheld information. Thus, it is difficult for affected people, general public, consumers, investors or even the very management of these enterprises to understand the scope and impact of corporate operations on legally protected public interests and the respective responsibilities of the corporate actors and directors involved.

3. Mitigating the practical obstacles facing victims.

Obstacles such as: the impossibility to obtain evidence, high financial costs and risks of litigation, intimidation, or physical inability to bring claims have a chilling effect on the exercise of victims' rights. The civil procedure laws of Member States alleviate such obstacles by means of different tools, including class actions, public interest litigation, exceptions from *loser-pays* principle, exemplary damages and disclosure

of evidence. These tools should be reviewed and EU law should provide for harmonised minimum standards of civil procedure for disputes involving human rights and environmental claims.

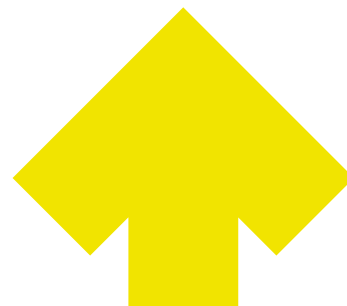
This report summarises the conclusions of legal research undertaken by European Coalition for Corporate Justice ('ECCJ') during the last three years, which has been reviewed and developed by an array of high profile lawyers, academics and human rights advocates. If the EU is to become sustainable and successful for all its citizens, while respecting the rights of the people and the protection of the environment around the world, urgent change to the legal frameworks governing MNEs she hosts is required. This report is designed to provide a comprehensive, relevant and realistic legal tool kit to empower the EU to deliver this necessary and urgent reform.

PART I

CURRENT OPPORTUNITIES

This part highlights what changes to the EU's corporate reporting framework, coupled with amendments to the rules governing legal actions before a court, would significantly improve the accountability of EU hosted MNEs. It proposes that this be attained by introducing legal requirements for MNEs to report on the impacts of their operations both in the EU and internationally, with the mandatory introduction of clear, audited, comparable and enforceable standards for large and medium-sized companies.

Part I also considers changes to private international law that would result in improvements for third-country victims of MNEs to access a remedy. Specifically, the proposals address law defining the competence of Member State courts to adjudicate private law disputes with a foreign element (Brussels I Regulation), and the determination of applicable law in relation to such disputes (Rome II Regulation).



CHAPTER A

HUMAN RIGHTS AND ENVIRONMENTAL REPORTING

"The EU and the EU Member States could further specify existing reporting requirements on environmental and social impacts, and clarify when and under what conditions human rights risks and impacts should be disclosed, including human rights and environmental impacts of third-country subsidiaries and suppliers of European corporations."

(Study of Edinburgh University on the legal framework for human rights and the environment applicable to EU companies operating outside the European Union prepared for the European Commission)¹

Lack of information on corporate operations is a major factor inhibiting corporate accountability and responsible behaviour. This is because MNEs operate through myriads of subsidiaries and sub-contractors for which they have no positive legal duty to supervise and it is unknown to outsiders how they manage them. Furthermore, it is difficult to assert causality between complex industrial operations and impacts on societies, people and the environment. If the right information is not collected, analyzed and duly disclosed, it is difficult for affected people, general public, consumers, investors or even the very management of these enterprises to understand the scope and impact of corporate operations on legally protected public interests and the respective responsibilities of the corporate actors and directors involved.

Despite the proliferation of Corporate Social Responsibility ('CSR') reporting and attempts by various platforms to establish common reporting standards, the reports produced by companies contain environmental and social data that is at best difficult, and 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 focusing instead on less controversial topics. The absence of a clear, comparable and mandatory standard at the EU level is unsustainable because CSR reporting has become a de facto requirement. Lack of harmonisation is of concern to both private and public investors. The European Investment Bank CSR statement ensures compliance of EIB funded projects with environmental and social aspects. Similar expectations are put on Member States' export credit agencies. EU legislation allows for social and environmental criteria in public procurement and the European Commission has recently published a guide for social procurement.

The reason for this failure is a combination of several factors. First, there is a confusing mix of mandatory and voluntary reporting. Then, there are too many differing standards. These standards are too complex: mixing together information on qualitative CSR performance, quantifiable impacts, and impacts on human rights, and other legitimate interests protected by law. There is a lack of legal certainty as to the notion of sphere of responsibility and complicity in abuses. The extent to which a company or its directors may assume liability for their own acts or for their complicity in government or third person activities is not clearly defined. This lack of clarity, let alone non-availability of enforcement mechanisms and sanctions, undermines the positive effects corporate reporting may have and limits this to a mere public relations tool.

EU law has harmonised rules of Member States on corporate financial reporting and requires companies to report also on key non-financial indicators. The Fourth and Seventh Directives on Company Law, as amended by The Accounts Modernisation Directive,² provide

¹ Augenstein, Daniel et. al, Study on the legal framework for human rights and the environment applicable to EU companies operating outside the European Union, University of Edinburgh, 2010 ('Study of the Edinburgh University'), para 232. For further details see paras 190-204 and 230-233. The study has been prepared for, and at the request of, the European Commission. It is available for download at the European Commission Enterprise and Industry Directorate-General website: http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/human-rights/index_en.htm.

² 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 (*OJ L 222, 14.8.1978, p. 11–31*) and Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (*OJ L 193, 18.7.1983, p. 1–17*) as amended by 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*), also known as The Accounts Modernisation Directive.

for Member States to ‘where appropriate’ permit or require companies to include information relating to environmental and social matters in their annual and consolidated annual report.³ Pursuant to relevant Articles, the annual report shall provide a ‘balanced and comprehensive analysis of the development and performance of the company’s business’, including ‘to the extent necessary for an understanding of the company’s development, performance and position... non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters’.⁴ The Seventh Company Directive on Consolidated Accounts requires that annual reports include consolidated data on other undertakings that are under effective control of the reporting company, regardless of whether they operate inside or outside the EU. The Directives also require Member States to hold the management of companies liable for the fulfillment of reporting duties and to establish effective and dissuasive penalties.

The trouble is that the Directives do not provide clarity in respect of ‘where it is appropriate’ for companies to include non-financial information in their reports, nor do these define which information should be disclosed. The only reference made is to the Commission Recommendation 2001/453/EC of May 2001 which contains guidelines on adequate environmental reporting as to disclosure of environmental expenditures and liabilities. In other words, companies are subject to this duty if they think that the relevant issues are material to their financial situation and outlook. A reporting duty defined in such manner is unenforceable save in the situations where it is clear that the company would suffer significant financial loss, for example in form of legal liability or a major drop in share value as a result of its complicity in environmental, human rights or similar abuse.

Several European countries, including Belgium, Denmark, France, Norway, The Netherlands and Sweden, have provided for more detailed definitions of when companies should report and on what non-finan-

cial data to include.⁵ Their experience provides important lessons, both in terms of positive experience and of the shortcomings of the discretionary approach adopted in the Directives.

In practice, the existing framework results in a situation where companies invest a lot of energy in producing complex reports that are of little value both to themselves and their stakeholders, including the general public. Building on this experience, the Directives should be amended to provide a simple, straight-forward and harmonised framework of mandatory reporting. The Directives should recognise that human rights and environmental considerations are material for the purpose of a company’s commercial activities, regardless of their (lack of) impact on a company’s short-term financial condition. Further, EU law should provide for details of the content and scope of the reporting duties. Finally, the enforcement mechanisms should provide for legal standing of other stakeholders beside shareholders who have legitimate interests in the information provided, in particular potential victims of abuse.

► REFORM OF THE REPORTING DIRECTIVES

Greater transparency by reforming reporting requirements can help to establish human rights and environmental protection as core business concerns. Disclosure of right information is crucial for affected people to assert their rights; it enables stakeholders and public to fulfil their control role; and provides tools for companies to prevent damages and avoid complicity in violations of international standards. ECCJ believes that in order to achieve these objectives the reform of existing legal framework should include the following elements.

3 The Preamble of Directive 2003/51/EC clarifies that Member States ‘may choose to waive the obligation to provide non-financial information’.

4 See Article 46 of the Fourth Directive and Article 36 of the Seventh Directive.

5 Belgian Bilan social belge (loi du 22 décembre 1995), Danish 1995 Green Accounts (Environmental Protection Act as amended in June 14 1995 by Act No. 403, and statutory order No. 975, of December 15, 1995) and Danish 2008 Accounting for CSR in large businesses Act (Act amending the Danish Financial Statements Act of 16 December 2008), 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).

1. Report status

a) A non-financial report shall be part of the annual financial report sent to the regulatory authorities. As put in the Study of Edinburgh University: *'The insight that corporate human rights and environmental abuses can have significant negative impacts on the corporation's economic development provides a strong rationale for further incorporating human rights and environmental considerations into existing directors' duties and reporting requirements.'*⁶

b) Reporting on human rights, environmental impacts and corruption issues shall be mandatory regardless of their materiality to the financial position of the reporting company. Currently this obligation is limited *'to the extent necessary for an understanding of company's (financial) development, performance and position'*.

2. Those subject to the reporting duties

The non-financial reporting 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) should be excluded from this obligation.⁷ However, in certain cases this protection might be lifted. For example, if the enterprise operates or owns certain facilities or conducts specific activities abroad that would be otherwise sanctioned by European environmental law, or achieves certain volume of trade with developing countries.

3. The enterprise structure and its sphere of responsibility

The companies should identify other persons or organizations, 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. In particular, companies should describe their supply chain and identify their suppliers to ensure traceability of their products.⁸

4. Content of the report

The reports should consist of an analysis of the risks of human rights and environmental abuses, as expressed in international conventions listed in Annex III of the EU Generalized System of Preferences, facing the company's operations or its sphere of responsibility and the description of steps taken by the undertaking to prevent and eliminate the identified risks.⁹

5. Evaluation and verification

The European Commission should make regulations for the presentation and audit of the non-financial information. Such regulations shall require that:

a) 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 per-country and, where purposeful, on per-activity basis.

b) Non-financial information shall be audited by an independent auditors accredited by the public authorities. The auditors should receive and review information from the third parties prior to completion of the audit.

⁸ *The sphere of responsibility* is a narrower concept than that of *"the sphere of influence"*. The notion of influence is itself too extensive to provide a basis for a company's legal responsibility for human rights abuses. In defining the responsibility it should be considered factors of control (whether contractual or shareholding), causation, benefit, duration and severity of the human rights impact, overlap of staff within the company's management, purchasing a high percentage of the supplier's output, and providing significant amount of finance. For more information 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>.

⁹ EU GSP is set by Council Regulation (EC) No 980/2005, of 27 June 2005. (OJ L 169/30.6.2005, p. 1-43). The list in its Annex III 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, The Convention on Biological Diversity, Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, and United Nations Convention against Corruption.

⁶ Study of Edinburgh University, para 232.

⁷ The definition of Small and Medium Enterprises is derived from existing accounting rules in the Seventh Company Directive and Fourth Company Directive, where it is based on annual turnover and number of employees.

6. Sanctions and enforcement

In the event the company fails to accurately report required information it should be liable for effective, proportionate and dissuasive sanctions. Members of the public, in particular those whose ability to exercise their rights depends on the information held by the company, should have access to judicial procedures to challenge such failures and to require the disclosure of the information and imposition of sanctions.

▶ II. KEY CSR PERFORMANCE INDICATORS

In addition to the aforementioned, the European Commission may require companies to report on their CSR performance. CSR reporting has different objectives and effects than the framework proposed above. It is not primarily designed to ensure protection of human rights and the environment or the legal compliance in concrete cases. Its aim is to provide an overall picture of company's performance beyond legal requirements, enabling stakeholders and public to assess the company.

In order to ensure quality and comparable CSR reporting, it would be necessary to develop specific sets of concrete and unambiguous key performance indicators tailored for each business sector. 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. The indicators should be specific enough to enable public and stakeholders to compare the reports. For this reason, the European Commission should develop them on the basis of multi-stakeholder process.



CHAPTER B

REFORM OF EUROPEAN PRIVATE INTERNATIONAL LAW

EU law has harmonised rules of private international law, that is, rules on the competence of Member State courts to adjudicate private law disputes with a foreign element and to determine the law applicable to such disputes. These rules provide a framework for compensation claims in courts of Member States arising from human rights and environmental abuses that have occurred in third countries. In many cases, the possibility to bring such a claim is the only option for victims to have their case fairly heard and to obtain redress. Such cases generate a lot of publicity which works as a strong incentive for the companies involved to compensate victims promptly and for other businesses to act responsibly and avoid complicity in similar cases.

Key EU legislation in this field – Brussels I and Rome II Regulations – will be examined by the incumbent European Commission. As presented in the Study of Edinburgh University, which has been commissioned by the European Commission, and as outlined in the proposals below, their reform presents significant opportunities for ensuring greater access to justice for third-country victims of human rights and environmental abuses committed by MNEs operating in the EU. Equally, the reforms must not be carried out at the cost of denying justice to claimants who would, under the law as it stands, currently have access to the courts of a Member State.¹⁰

¹⁰ Study of Edinburgh University, paras 205-225 and 234-237.

► I. JURISDICTION

"[N]otwithstanding concerns raised by a number of Member States during the consultation process, it could be considered to extend the Brussels I Regulation to corporations not domiciled in the European Union. One possibility would be to amend Article 6 Brussels I Regulation, in line with the law of some EU Member States, to enable claimants to sue a subsidiary domiciled in a third country together with the European parent corporation... It could also be considered to create additional grounds of jurisdiction, including forum necessitatis."

(Study of Edinburgh University on the legal framework for human rights and the environment applicable to EU companies operating outside the European Union prepared for the European Commission)¹¹

The rules on jurisdiction are governed by Brussels I Regulation.¹² Accordingly, persons (including companies) domiciled in a Member State could be, whatever their nationality, sued in the courts of that Member State. This principle provides an important vehicle for victims of human rights abuses to bring claims for compensation against EU domiciled companies. For defendant companies that are not domiciled in the EU, questions of jurisdiction are largely governed by national rules and Member States have widely differing national approaches to jurisdiction, which present a range of opportunities and limitations to civil claimants seeking compensation for human rights and environmental abuses.¹³

A crucial unsettled question is whether claimants can sue a subsidiary domiciled in a third country together with the European parent company. Given the complexity of MNEs' structure and decision-making processes and the impeding effects of principles of separate legal personality and limited liability, such possibility would significantly improve victims' position. Further, laws of Member States give differing answers as to when their courts can assert jurisdiction over parent companies that are not domiciled in the EU but which carry out

¹¹ Study of Edinburgh University, para 235.

¹² 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*).

¹³ For more information see: de Nuyts, A. et al., Study on Residual Jurisdiction, 2007. This study has prepared on request and for the European Commission. Available at http://ec.europa.eu/civiljustice/news/docs/study_residual_jurisdiction_en.pdf.

substantial operations here through their subsidiaries. A harmonisation of this issue is necessary to protect MNEs based in the EU against unfair competition, and to prevent MNEs avoiding potential liability by relocating the parent to a third country. Finally, 10 Member States recognise the concept of *forum necessitates*, which allow their courts to hear cases that could not be heard in countries where the harm occurred, because of, for example, ongoing civil war or ineffective judicial system.

Therefore, ECCJ believes that harmonisation of this *residual jurisdiction* is highly desirable from the perspective of ensuring better access to justice.¹⁴ This harmonisation should reflect the shared understanding of Member States as to the range of circumstances in which it is appropriate for jurisdiction to be exercised against non-EU domiciled defendants. Equally, harmonisation must not be carried out at the cost of denying justice to claimants who would, under current law, have access to the courts of a Member State. The EU internal market should not serve as a driver for corporate abuse in third countries where justice cannot be delivered to the victims of such abuse.

If the grounds for jurisdiction under the Regulation applicable to non-EU domiciled defendants were to be defined too narrowly, a competitive advantage for those defendants might be created, compared with EU domiciled defendants, in respect of their activities outside the EU. For example, while an EU domiciled corporation (doing most of its business in the EU) would be appropriately subject to the jurisdiction of a Member State court in respect of tortious activities involving human rights abuses outside the EU, a non-EU domiciled corporation (also doing most of its business in the EU) would escape that jurisdiction for similarly tortious activities if the rules of the Regulation were too narrowly defined. This would create an incentive for ‘free rider’ corporations to locate their domicile outside the EU, even if most of their business activity is carried out within the EU.

Additional rules should therefore be introduced into the Regulation that apply to non-EU domiciled defendants. These should be both more extensive than the existing rules under the Regulation and also more flexible, to recognise that the appropriateness of exercising jurisdiction will depend upon the circumstances of each individual case. Where significant territorial or business connections

with a Member State exist, concerns of comity should not prevent the expansion of grounds for jurisdiction, particularly over MNEs whose activities are not focused on (or easily regulated by) any single State. In providing for flexibility, these rules must also reflect the concern for access to justice for claimants. Not only is this an EU value, but it is also reflected in a range of national rules of residual jurisdiction, including in particular the common law *forum non conveniens* test and the concept of a *forum of necessity*.

A rule could, for example, be introduced on the following terms:

(new) Article 5A

(1) A person not domiciled in any Member State may also be sued in a Member State in matters relating to human rights and environmental obligations if any one or more of the following applies:

(a) the person has a significant territorial or business connection with the Member State (even if the claim does not derive from that territorial or business connection);

(b) the claimant is domiciled in the territory of the Member State; or

(c) there is no other reasonably available forum which could fairly exercise jurisdiction over the dispute and the dispute has a sufficient connection with the Member State of the court seised.

(2) A court seised under section (1) above may decline jurisdiction if it is satisfied that, taking into consideration all the circumstances, including in particular the claimant's right of access to justice, it would be inappropriate to exercise jurisdiction over the dispute.¹⁵

¹⁵ The concept of *forum necessitatis* is already recognized in the law of the EU by the Regulation (EC) No 4/2009 of 18 December 2008 on jurisdiction, applicable law, recognition and enforcement of decisions and cooperation in matters relating to maintenance obligations, article 7. Its preamble in pt. 16 explains reasons and limits of this measure: “In order to remedy, in particular, situations of denial of justice this Regulation should provide a *forum necessitatis* allowing a court of a Member State, on an exceptional basis, to hear a case which is closely connected with a third State. Such an exceptional basis may be deemed to exist when proceedings prove impossible in the third State in question, for example because of civil war, or when an applicant cannot reasonably be expected to initiate or conduct proceedings in that State. Jurisdiction based on the *forum necessitatis* should, however, be exercised only if the dispute has a sufficient connection with the Member State of the court seised, for instance the nationality of one of the parties.”

¹⁴ Term *residual jurisdiction* refers to cases where the EU law currently does not provide uniform grounds of jurisdiction, but borrows the rules of national law.

► II. APPLICABLE LAW

In civil disputes with extraterritorial elements, the courts must choose which country's law should be applied. The respective rules of Member States are harmonised by Rome I Regulation for contractual obligations and Rome II Regulation for non-contractual obligations, also referred to as torts or (quasi)delicts.¹⁶ According to Rome II Regulation Article 4, courts shall apply the law of the place where the damage occurred. Article 7 allows victims of environmental abuses committed within a Member State which materialise outside the Member State to choose between the law of the Member State and the law of the third country. This exception cannot be extrapolated, however, to environmental damage in a third country caused by management failure of the parent company domiciled in the EU to supervise a third-country subsidiary. The existing rules have potentially three major adverse implications for disputes concerning damage in third countries which should be addressed in an amended Regulation.

First, the selection of the law of a third country precludes application of EU law, including rules on parent company liability. Second, the law of some countries might not in exceptional cases provide satisfactory protection of human rights which meets the demands of international law. Third, Rome II Regulation requires that courts use the law governing the substance of the claim also for determining remedies, including the amount of damages. Damages as determined by the law of a third country could be too low to serve as a meaningful remedy to victims and have the required deterrent effect.

Member State courts can, in theory, refuse to apply foreign law on the grounds that it is incompatible with their public policy. The courts are not, however, expressly required to do so in cases where the application of foreign law would legitimise manifest breaches of human rights and it is unsettled whether such claim could be derived

from European human rights law.¹⁷ Therefore Rome II Regulation should be amended so as to prescribe the application of the law of Member State in the aforementioned situations.¹⁸

A rule could, for example, be introduced in the following terms:

(new) Article 26A

(1) The application of a provision of the law of any country specified by this Regulation must be refused if such application would lead to any of the following:

(a) flagrant denial of human rights, denial of remedy for environmental damage or damage sustained by persons or property as a result of such damage, or adequate compensation for such damage; or

(b) exemption from liability for breaches of human rights and environmental damage conferred upon persons by the requirements of the law of the European Union.

(2) This article is without prejudice to the right of courts to apply exceptions from this Regulation based upon the public policy of the forum.

¹⁶ 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*).

¹⁷ Study of Edinburgh University, paras 224 and 237.

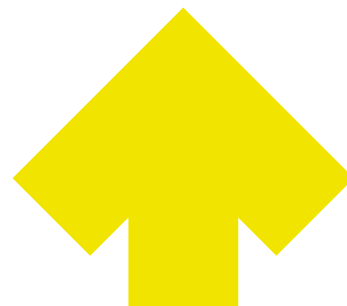
¹⁸ The public policy exception is defined in Article 26 of the Regulation. Pt. 32 of the Regulation's preamble further clarifies this option: "Considerations of public interest justify giving the courts of the Member States the possibility, in exceptional circumstances, of applying exceptions based on public policy and overriding mandatory provisions. In particular, the application of a provision of the law designated by this Regulation which would have the effect of causing noncompensatory exemplary or punitive damages of an excessive nature to be awarded may, depending on the circumstances of the case and the legal order of the Member State of the court seised, be regarded as being contrary to the public policy (*ordre public*) of the forum."

PART II

NEW CORPORATE ACCOUNTABILITY FRAMEWORK

In themselves, the reforms described in Part I of this report will prove insufficient to address the scale of the challenge. A comprehensive, long term, sustainable, legal and enforceable system for corporate accountability needs to be built. Part II therefore outlines needed systemic legal reforms. In summary, these entail:

- › Improving the governance in the operations of MNEs concerning foreign subsidiaries and sub-contractors
- › Improving disclosure of information
- › Mitigating the practical obstacles facing victims



➤ INTRODUCTION

MNEs fundamentally influence the societies and whole countries in which they operate. While this influence is often positive, on far too many occasions MNEs' operations contribute to abuses of human rights, or the environment or to corruption. This is a consequence of the legal framework in which corporations operate. Corporations are 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.¹⁹ These basic pillars of corporate structure insulate each legal unit of the MNE, including the parent company, from obligations of and to other members of the economic group.

¹⁹ 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, nor are they liable for its debts: they are the assets and liabilities of the company. It is this separate legal personality that makes companies an attractive vehicle for commercial ventures, as the liability rests with the company, rather than the shareholders, directors, members or company officers. The separate legal entity forms the basis for limited liability of shareholders. Shareholders' liability is limited to the minimal value of the shares allotted to them.

However, the underpinning of 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.²⁰ Implicit in this structure is the notion that a company acts solely in the economic interests of its shareholders. This imperative has often left behind a company's accountability to society at large. Even a company's accountability to its 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 are made with no input from those stakeholders or the wider public, and very little oversight even by shareholders.

When applied to the MNEs' structure, this legal framework has resulted in a governance gap as national regulations conventionally apply only to those constituent parts of the MNE that operate in the territory of that State, or have an effect on that territory. These companies may receive profits, or other benefits, from operations of other parts of the MNE, located outside that particular State jurisdiction, without exposing themselves to any liability for the environmental or human rights consequences of those operations. In the event that the State hosting those operations does not punish such violations, MNEs can benefit from complete impunity, and the additional profits generated by such conduct, whilst avoiding liability for the environmental and human rights costs. This inadequacy of law, on the one hand impedes access to justice for those affected by violations of international norms and on the other disadvantages responsible entrepreneurs and local European businesses. While official EU policy is to support CSR, the European legal framework favours irresponsible businesses.²¹

²⁰ 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 or it authorized or abetted the violation, or where the corporate structure has deliberately been used to advance fraud or other illegality or wrongful purposes. 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 a foreign direct liability of parent in United Kingdom was an central issue – *Connely v. RTZ* [1998] AC 854, *Lubbe v. Cape plc.* [2000] 1 WLR 1545, *Ngcobo v. Thor Chemical Holdings Ltd*, *Sithole v. Thor Chemical Holdings*. Examples exist also in criminal law. Recently, a French court has found the company Total liable on this basis for a criminal offence in regard of the tanker Erika disaster. Erika, interestingly, was operated by a subcontractor of Total's subsidiary.

²¹ For further analysis see: Fair Law, Gregor F., Ellis H., European Coalition for Corporate Justice, 2008. Available at http://www.corporatejustice.org/IMG/pdf/ECCJ_FairLaw.pdf

ECCJ believes there are significant opportunities within European law to improve the accountability of MNEs operating within the European market, as well as those based in Europe with operations in third countries. The proposed measures respect limitations imposed by international law while ensuring that MNEs (and also small businesses) with responsible environmental and human rights practices are not placed at a competitive disadvantage within the EU. The proposals are based on reforms in three areas:

1. A requirement on parent companies within the jurisdiction of Member States to exercise oversight and control of their subsidiaries and business partners in third countries in regard of their compliance with the international standards of human rights and protection of the environment.
2. Ensuring the right to access the information that is held by companies and that is required for the exercise or protection of fundamental rights.
3. Removing obstacles to access to European courts posed by:
 - a) rules of public international law, and
 - b) procedural law, including obstacles stemming from time limitations, costs, non-availability of public interest litigation and mass tort claims, and provisions on evidence.

This new framework is presented below in this chapter. The proposals for reform of reporting obligations (that form part of point 2.) and rules of public international law (point 3. a) are discussed in more detail in Part I of this report.

► I. PARENT COMPANY LIABILITY

"Exceptions to the doctrine of separate legal personality recognised in the corporate laws of the EU Member States could provide the basis for further clarifying under which conditions parent corporations should be liable for human rights and environmental abuses committed by their subsidiaries. On this basis, it could be considered to impose, through domestic regulation and in appropriately limited circumstances, a requirement on European parent corporations to exercise oversight or control over its subsidiaries in third countries, and to hold them responsible for failure to do."

(Study of Edinburgh University on the legal framework for human rights and the environment applicable to EU companies operating outside the European Union prepared for the European Commission)²²

The twin concepts of separate legal personality and shareholders' limited liability, which are at the heart of company law, are the major obstacle to holding a MNE liable for abuses committed by its third-country subsidiaries or business partners. The direct extraterritorial regulation of such third-country entities would be on most occasions considered too intrusive to the sovereignty of the concerned State. However, States may, where a recognised basis for jurisdiction exists, impose requirements on parent companies to control and prevent their subsidiaries in third countries from committing relevant offences.²³ This view has been echoed in the Study of Edinburgh University prepared for, and at the request of, the European Commission.²⁴ An example where States have resorted to extraterritorial jurisdiction and imposition of duties on parent companies is in the area of criminal responsibility for corruption of foreign officials. The new UK offence of 'failing to prevent' bribery by foreign subsidiaries and sub-contractors is a prominent example.²⁵

²² Study of Edinburgh University, para 230.

²³ See report of SRGS Protect, Respect and Remedy, A/HRC/4/35/Add.2, 2008, pt 19: "Recognized bases include where the actor or victim is a national, where the acts have substantial adverse effects on the State, or where specific international crimes are involved."

²⁴ Study of Edinburgh University, paras 188-191.

²⁵ Ibid, para 229. Bribery Act 2010, Chapter 23, available at <http://www.legislation.gov.uk/ukpga/2010/23/contents>. Other examples include 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.

ECCJ 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 allocate responsibility for such violations to the company having authority to control the entity that actually violated the standards – in short, to the parent company. Where such authority does not exist, a legal duty of care on the part of a parent company should be inferred to ensure that human rights and the environment are respected throughout the MNE's sphere of responsibility. 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 obligations:

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

The standards of parent company liability should differ dependent upon the nature of its relationship with the wrongdoing entity and the area of law in which such liability is implemented. As regards tort and civil law, the parent company should be strictly liable in any situation where that company has a real ability to exercise control over a subsidiary or affiliate. That is, in circumstances where the parent company disposes of a definite right (based on ownership, contractual or other relationship) to exercise a dominant influence over the subsidiary. The basis for such definition of 'control' by the parent company is provided in the Seventh Company Directive on Consolidated Accounts.²⁶ However, control may also arise from purely contractual business relationships with no (or limited) ownership of another company e.g. from a franchise, sub-contracting, joint ventures, or other complex contracts. In applying this definition of 'control' courts will necessarily have to enquire into the true economic, as well as legal, relationship between entities.

²⁶ Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (*OJ L 193, 18.7.1983, p. 1–17*).

In the field of criminal law, and where operations of legal persons not formally part of an MNE, such as suppliers and joint ventures, are concerned, the parent company should be liable if it cannot demonstrate it has complied with the duty to take reasonable steps to prevent abuse. This 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 in defining the scope of a parent 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 factors that would indicate a failure to meet this duty. A detailed analysis of this issue is beyond the scope of this report and is presented elsewhere.²⁷

Regulation of parent company liability can be introduced: either as a general measure covering all violations of international human rights and environmental standards; or in the form of measures per sector that focus on particular issues. These include, for example: forced labour, worst cases of child labour, pollution generated by extractive operations, illegal logging, or abuse of indigenous people's rights. The scope of the regulation should take account of the 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 such a regulation undermines international trade rules on free trade set by the World Trade Organisation (WTO). The EU and its Member States should therefore restrain from making MNEs operating in the European market liable extraterritorially for more than that which can be justified on the basis of the interest of the international community, as defined in international treaties and customary law.²⁸

²⁷ Fair Law, p. 23–24.

²⁸ An overview of such treaties is provided in Annex III of the EU Generalized System of Preferences (GSP). 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*). 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, The Convention on Biological Diversity, Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, and United Nations Convention against Corruption.

A good opportunity for reform of the corporate accountability framework suggests itself with the review of the **Environmental Liability Directive** scheduled for 2014.²⁹ The Directive is the first piece of EU legislation whose main objectives include the application of the '*polluter pays*' principle. It establishes a common framework for liability with a view to preventing and remedying damage to animals, plants, natural habitats and water resources, and damage affecting land. However, the Directive does not apply to extraterritorial damage, unless it physically originates from the EU, and it is of no prejudice for civil liability of the company operating the polluting facility neither of its directors or other individuals. It merely regulates duties owed by the polluter to the Member State authorities. This scheme is not applicable to extraterritorial cases because the principles of international law don't enable EU to dictate to companies the rules of their relationship with the authorities of third States. Therefore, ECCJ proposes that the Directive be amended so as to require parent companies of EU hosted MNEs to oversee operations of their subsidiaries with the aim to prevent any unlawful pollution and to improve access to Member States courts for victims of any such pollution.

On the basis that parent companies based in the EU will be liable as set out above, non-EU based parent companies should not, within the EU, be able to profit, or seek competitive advantage, from human rights or environmental abuse. Access to the European market for all MNEs should be based on internationally recognised human rights and environmental standards. This would require amending EU private international law, namely **Brussels I Regulation**, which sets rules for jurisdiction of Member State courts and is crucial for third-country victims' access to judicial remedy in the EU. The proposed reform is presented in closer detail in Part I of this report.

II. ACCESS TO INFORMATION

Right to access the information is a key to exercise of all other fundamental rights. In the EU and its Member States, this right is guaranteed to people in respect of information which is held by public authorities. However, the companies are not obliged to disclose most of the information relevant to their operations in third countries, neither to public authorities nor directly to public. This inhibits corporate accountability and responsible behaviour as well as ability of people affected by those operations to exercise their rights. The MNEs operate through myriads of subsidiaries and sub-contractors for which they have no positive legal duty to supervise and it is unknown to outsiders how they manage them. Furthermore, it is difficult to assert causality between complex industrial operations and impacts on societies, people and the environment. If the right information is not collected, analyzed and duly disclosed, it is difficult for affected people, general public, consumers, investors or even the very management of these enterprises to understand the scope and impact of corporate operations on legally protected public interests and the respective responsibilities of the corporate actors and directors involved.

Therefore, the EU legislation should be amended to ensure public the right to access the information that is held by companies. A disclosure of information by companies can be either proactive or reactive. The first means that the companies should be required to prepare and disclose an analysis of the impacts of their operations on human rights, the environment and other protected public interests, for example as a part of their annual report. The proposal for such reform of existing EU law is described in detail in Part I of this report.

Reactive disclosure means that people could request a company to provide them specific information they identify. Such a right, to be effective and also not too burdensome on companies, would have to be appropriately limited and specified in scope and balanced with the interests that might provide exceptions from company's obligation to disclose the information. It must be also backed up by an effective dispute resolution mechanism.

²⁹ Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ L 143, 30.4.2004, p. 56–75).

III. ACCESS TO JUSTICE

"[I]t should be stressed that even if third-country victims of corporate abuse succeed in securing access to EU Member State courts, they will face very significant procedural obstacles in obtaining redress from MNCs including obstacles pertaining to time limitations, legal aid and due process, non-availability of public interest litigation and mass tort claims, and provisions on evidence... The European Union and the EU Member States should address these procedural obstacles as part of their State duty to protect."

(Study of Edinburgh University on the legal framework for human rights and the environment applicable to EU companies operating outside the European Union prepared for the European Commission)³⁰

The access to courts in the EU for human rights and environmental abuses committed by subsidiaries or contractors of companies under EU jurisdiction outside the EU is impeded by rules of **private international law** which are governed by Brussels I and Rome II Regulations. Their reform, such as enabling claimants to sue a subsidiary domiciled in a third country together with the European parent company, and creating additional grounds of jurisdiction, including *forum necessities*, would be relatively straightforward to introduce and would result in significant improvements to the impacts of EU companies operations outside the EU. The details of this reform are described in Part I of this report.

Apart from this, the victims both from third-countries and Member States face various barriers created by **civil procedural law**, including obstacles stemming from time limitations, financial costs, non-availability of public interest litigation and mass tort claims, and provisions on evidence. Legislation of Member States recognises various tools to alleviate such obstacles, however, their application and availability differ from Member State to Member State. The reform of these rules, while crucially important to the ability of victims to exercise their rights, does not have an extraterritorial effect and as such does not conflict with principles of international law. This issue has been highlighted and Member States have been encouraged to reform their

law both by the work of the United Nations Special Representative of the Secretary General on human rights and transnational corporations and the Study of Edinburgh University.³¹

Therefore, ECCJ proposes that the EU, based on the experience of its Member States, should set common minimum procedural standards for civil disputes involving claims from victims of human rights and environmental abuses. These standards should provide for exceptions from the standard rules of procedure with the aim to ease financial and evidential burdens facing disadvantaged victims where there is a clear public interest in permitting litigation while protecting defendants from frivolous claims. The proposed measures include:

1. Class actions

Victims should have an opportunity to join their claims and to act collectively in all Member States against a particular corporate abuse. This would be particularly important for victims of environmental harm, which may affect a widely spread group. A collective (class) action in such cases can improve access to the courts by reducing the costs for individual claimants.

2. Time limitations

The period of time in which to bring claims based on human rights abuse should be prolonged to enable victims to take action. The position of victims from third countries: affected by the severity of abuse, the cultural environment, their economical situation and possible intimidation often does not allow them to meet the strict time limitations applicable to common civil claims.

3. Access to evidence

A minimum level of disclosure of evidence to victims of corporate abuse should be ensured across the EU. Much of the evidence necessary to prove a case in compensatory damages is often concealed and, being held by the defendant or by third parties, usually not known by the claimant in sufficient detail.

³⁰ Study of Edinburgh University, para 238.

³¹ Report of the UN SRSG, 'Business and human rights: Further steps toward the operationalisation of the 'protect, respect, remedy' framework', UN Doc A/HRC/14/27 (9 April 2010), paras 109-112. Study of Edinburgh University, para 238.

4. Exceptions from loser-pays principle

Liability for the litigation costs in cases involving human rights and protection of the environment should be shifted to defendants where there is a significant economical disparity between the parties of the dispute unless the case is proved to be purely unmeritorious. Victims should not be discouraged from seeking justice by a risk of extensive costs of litigation arising from the *loser-pays* principle. Alternatively, the litigation costs incurred by the victims of the abuse, including those to be paid as a result of *loser-pays* principle, should be covered by a special State legal aid fund established for this purpose.

5. Multiple damages

The deterrent effect of private litigation on companies should be improved. Victims of the most serious abuses should be awarded *multiple damages*.³² This measure targets those situations where corporate profit from particular misbehaviour greatly exceeds the amount of potentially available sanctions (including the ordinary measure of damages for the victims) that might be adjudicated.

6. Public interest litigation

Anyone affected, as well as non-governmental organisations promoting public interest endangered by a corporation's non-fulfillment of its particular duty under public law regarding protection of human rights or the environment, should be entitled to seek injunctive relief and/or an administrative or criminal penalty directly against the wrongdoer before a court.

³² Monetary compensation awarded to an injured party that goes beyond that which is necessary to compensate the individual for losses and that is intended to punish the wrongdoer.

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