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European Coalition for Corporate Justice

Executive Summary

Fair Law:

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

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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).

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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

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.

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 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,

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

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.

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 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.