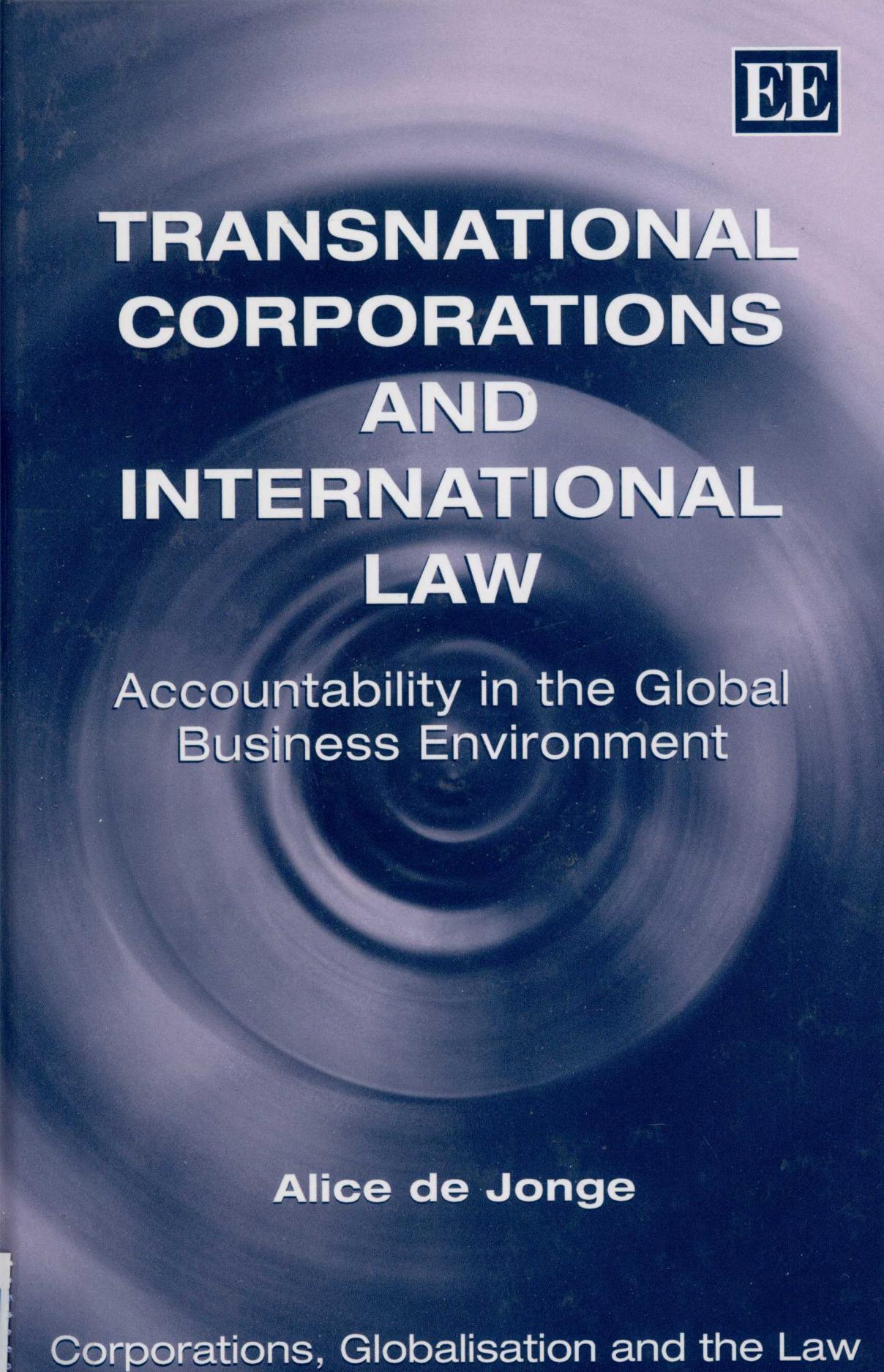

EE
TRANSNATIONAL CORPORATIONS AND INTERNATIONAL LAW
Accountability in the Global Business Environment
Alice de Jonge
Corporations, Globalisation and the Law

# Transnational Corporations and International Law

## Accountability in the Global Business Environment

Alice de Jonge

*Department of Business Law and Taxation, Faculty of Business and Economics, Monash University, Australia*





CORPORATIONS, GLOBALISATION AND THE LAW

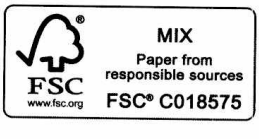
**Edward Elgar**
Cheltenham, UK • Northampton, MA, USA

Published by
Edward Elgar Publishing Limited
The Lypiatts
15 Lansdown Road
Cheltenham
Glos GL50 2JA
UK

Edward Elgar Publishing, Inc.
William Pratt House
9 Dewey Court
Northampton
Massachusetts 01060
USA

A catalogue record for this book is available from the British Library

Library of Congress Control Number: 2010934053




ISBN 978 1 84980 368 7

Typeset by Cambrian Typesetters, Camberley, Surrey
Printed and bound by MPG Books Group, UK

*To Ian*

# Abbreviations

| | |
|---|---|
| AIB | Association of International Business |
| ASX | Australian Securities Exchange |
| ATCA | Alien Tort Claims Act (US) |
| BIT | bilateral investment treaty |
| CLCC | Civil Law Convention on Corruption |
| COP | Communication on Progress |
| CSR | corporate social responsibility |
| ECOSOC | UN Economic and Social Council |
| EITI | Extractive Industries Transparency Initiative |
| EPFI | Equator Principles Financial Institution |
| FDI | foreign direct investment |
| FDIS | Final Draft International Standard |
| FSIA | Foreign Sovereign Immunities Act (US) |
| GATT | General Agreement on Tariffs and Trade |
| GRI | Global Reporting Initiative |
| IBA WG | International Bar Association Working Group |
| ICC | International Criminal Court |
| ICJ | International Court of Justice |
| ICL | international criminal law |
| ICSID | International Centre for Settlement of Investment Disputes |
| ICTR | International Criminal Tribunal for Rwanda |
| ICTY | International Criminal Tribunal for the former Yugoslavia |
| IFC | International Finance Corporation |
| IFI | international financial institution |
| ILC | International Law Commission |
| ILO | International Labour Organization |
| ISO | International Organization for Standardization |
| ISO WG | ISO Working Group |
| MAI | Multilateral Agreement on Investment |
| MIT | multilateral investment treaty |
| MNE | multinational enterprise |
| MoU | Memorandum of Understanding |
| NAFTA | North American Free Trade Agreement |
| NCP | National Contact Point |
| NGO | non-governmental organization |

| | |
|---|---|
| NGPF | Norwegian Government Pension Fund Global |
| NHRI | national human rights institution |
| OECD | Organisation for Economic Co-operation and Development |
| PNG | Papua New Guinea |
| PRI | Principles for Responsible Investment |
| RICO | Racketeer Influenced and Corrupt Organizations Act (US) |
| SIF | Social Investment Forum |
| SR | social responsibility |
| SRSG | Special Representative of the Secretary-General |
| TNC | transnational corporation |
| TVPA | Torture Victim Protection Act (US) |
| UN | United Nations |
| UNCLOS | United Nations Convention on the Law of the Sea |
| UNCTAD | United Nations Conference on Trade and Development |
| WHO | World Health Organization |
| WTO | World Trade Organization |

# Contents

# 1. The corporation: a good tool but a bad master

## A. INTRODUCTION

The corporation has been described as 'the most effective structure for capital accumulation', having 'the potential to demonstrate an effective management system' because 'it allows a separation of ownership from management'.[1] In other words, the usefulness of the corporate form – indeed the very basis of its creation and continued existence – stems from the fact that the 'corporate body is not a natural person but has legal personality attributed to it by the law ... Additionally it has a legal *persona* separate from that of its investors'.[2]

But the corporation, particularly the global corporation, is also much more that a legal concept. It is, increasingly, a very significant economic, political and social presence in today's world.[3] According to the 2009 World Investment Report by the United Nations Conference on Trade and Development (UNCTAD), there were, in 2009, an estimated 82,000 transnational corporations (TNCs) worldwide, with 810,000 foreign affiliates.[4] The Report goes on to note that 'these companies play a major and growing role in the world economy. For example, exports by foreign affiliates of TNCs are estimated to account for about a third of total world exports of goods and services, and the number of people employed by them worldwide totalled about 77 million in 2008 – more than double the total labour force of Germany'.[5] It has been estimated that of the top 100 economies in the world, 51 are corporations and only 49 are states.[6]

The fundamental role played by TNCs in global trade and the global economy generally has been acknowledged by the WTO and other international bodies.[7] TNCs also play a major role in, and have a significant impact upon, local economies at all levels, national, provincial and local. Governments everywhere recognize the role of TNCs in economic development, particularly through global direct investment.[8] Governments are also prepared to deal with TNCs on a virtually equal basis under a growing number of bilateral investment treaties (BITs) which allow TNCs the right to initiate international arbitration directly against a host state for alleged breaches of BIT rights.[9]

These facts alone demand much more than a dictionary definition in answer to the question 'what is the *nature* of the corporation as a participant in the

global economy, in global and local politics and society?' One answer is provided by those who argue that corporations are, by nature and by law, bound to act selfishly.[10] In the words of one commentator, 'Businesses have no purpose other than reproducing themselves profitably. If *en route* to this project they develop new technologies, ... and generate employment they are all besides the point. Businesses' business is business'.[11]

This book challenges such a view of the corporation, particularly the corporation as a participant in the process known as 'globalization'. A number of writers have reminded us that economic growth should not be valued simply for its own sake. David Kinley, for example, argues that the economy should be seen as a means to an end – an improved quality of human life – rather than an end in itself.[12] This book is similarly based on the belief that the corporation should be seen as a vehicle to an end, rather than an end in itself. In particular, the TNC, as a member of the global community, should be seen as a valuable vehicle for promoting the welfare of global society. The TNC should also be designed and regulated in a way which best promotes the global good and the realization of globally agreed goals, including the Millennium Development Goals[13] and the environmental goals agreed upon in 2009 at Copenhagen and other environmental forums.[14]

Kinley also calls for recognition of the interdependency between global corporate activity and international human rights law. His latest book, *Civilizing Globalisation*, points to this inter-dependency within the broader context of the link between the global economy and human rights.[15] *Civilizing Globalisation* takes a broad look at all three arms of the global economy – trade, aid and global business – and their impact on human rights. In this book, my focus is much more narrow, but deeper. I examine global business, in particular the TNC, in much more detail. This first chapter begins by exploring the nature of the corporation as a legal entity: the nature of its personhood. Non-corporate global entities and organizations, both inter-governmental organizations and non-governmental organizations (NGOs), can certainly have an important influence on human rights; and there are important debates to be had about the role and status of each of these entities under international law. The special focus of this book, however, is upon the TNC – the legally incorporated entity doing business in more than one nation.

This first chapter examines the legal definition, nature and form of the corporation as it currently exists in different legal systems around the world. The focus is on the modern form of the corporation in different common law and civil law systems, the aim being to explore whether one corporate form might be more conducive to good social citizenship than others. Chapter 1 also explores the expanding acceptance of the concept of corporate social responsibility, and the different varieties of codes and other instruments aimed at recognizing and facilitating socially responsible corporate behaviour.

Chapter 2 begins by reiterating both the mammoth capacity of TNCs for great good, and also their ability to perpetuate great harm. The great disparity between the significant impact of TNCs in global business and society, on the one hand, and the virtual refusal of international law to recognize the activities of TNCs as coming within its ambit, on the other, is highlighted. Chapter 2 examines the ways in which TNCs have responded to international criticism and concern by attempting to 'self-regulate' through voluntary codes of conduct. Different approaches to adopting and implementing such codes, some more successful than others, are explored. In Chapter 3, the focus is on the relationship between host states and foreign TNCs under BITs and other international instruments. The ways in which these treaties appear to protect TNC rights, while remaining silent on TNC responsibilities, is illustrated using a number of case examples. The ways in which host states have attempted to overcome this deficit through regulatory measures establishing standards for corporate behaviour are then explored. The limitations of such efforts to regulate corporate behaviour are highlighted.

Chapter 4 examines the way in which some home states have sought to plug existing gaps in international law by enacting extra-territorial legislation allowing TNCs to be held accountable for breaches of international standards. The significant legal problems that need to be overcome by individuals and NGOs making use of such legislation are highlighted by examining a range of cases, mostly unsuccessful, involving litigation against TNCs for human rights and environmental harms. Chapter 5 then examines the theory and practice of corporate criminal liability for extra-territorial harms.

Chapters 6 to 9 present an alternative solution to the problem of holding TNCs accountable for their conduct away from home. Chapter 6 outlines a set of theoretical principles for bringing TNCs under the jurisdiction of international law in respect of their global activities. At United Nations level, a concept of 'sphere of influence' has been used within the context of the Global Compact[16] and the Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises[17] in attempting to define the responsibilities and potential liabilities of TNCs. The problems with this concept have been emphasized on a number of occasions by the Special Representative of the Secretary-General (SRSG), Professor John Ruggie.[18] Professor Ruggie suggests that a more appropriate anchor for defining the international responsibilities of TNCs is the duty to take reasonable measures to avoid complicity in human rights abuses – a concept akin to the common law concept of due diligence. The obligation to exercise due diligence forms an essential element of what Ruggie has identified as the corporate duty to respect human rights. The corporate duty to respect human rights, in turn, is an essential pillar in Ruggie's 'Protect, Respect and Remedy' Framework for business and human rights,[19] about which more will be said.

What is missing from the SRSG's current vision of TNCs' 'responsibility to respect human rights' is the vital element of enforceability. In Chapter 6, I highlight similarities between Ruggie's description of the 'corporate responsibility to respect' on the one hand, and the International Law Commission's Draft Articles on the Responsibility of States for Internationally Wrongful Acts ('Draft Articles')[20] on the other. Chapter 6 then offers the Draft Articles as an appropriate model for building a set of theoretical principles to govern TNC liability for internationally wrongful acts.

Chapter 6 further argues that just as TNCs have already been invited to sign up to the Global Compact (as discussed in Chapter 2), so also should they be invited to sign up to other international standard-setting instruments as well. This process should be just as voluntary as it is for states when deciding whether to sign up to treaties. When a TNC has appropriately indicated its consent to be bound by a treaty, however, that treaty should be just as binding on the TNC as on states parties to the treaty. In addition, just as states are also bound by certain mandatory, fundamental rules of general international law known as *jus cogens*, so should TNCs likewise be subject to those same peremptory norms.

Chapter 7 then explores institutional avenues for holding TNCs accountable for internationally wrongful acts. It is argued that TNCs should also be invited to sign up to one or more voluntary, graduated enforcement mechanisms, ranging from simple reporting obligations (such as currently imposed on Global Compact signatories), to submission to complaints-handling tribunals. In relation to human rights norms, TNCs could be invited to submit to scrutiny by one of the regional or international human rights tribunals that currently supervise compliance by states with human rights obligations. There may even be scope for a new World Court of Human Rights,[21] something proposed as early as 1947 but still stigmatized as utopian.

It is likely to be some time before TNCs will submit to scrutiny, let alone complaints handling, by human rights tribunals. In the meantime, it may be more acceptable for BITs to incorporate some minimal and basic, but important, responsibilities for foreign investor corporations that wish to enjoy the rights bestowed by those BITs. For example, BIT rights could be extended more readily to corporations signing up to the Global Compact minimum standards. Questions and disputes arising under these more modern BITs could then continue to be settled by existing arbitration bodies. This idea is also explored in Chapter 7.

If it is accepted that international law does and should impose responsibilities on TNCs, should there also be criminal liability for corporations under international law? Individuals can already be prosecuted for interna-

tional crimes before the International Criminal Court (ICC).[22] Should TNCs likewise be invited or obliged to submit to the jurisdiction of the ICC? While the idea may initially be appealing, there are two major problems. First, there are the significant and powerful political interests that would oppose any proposal to expand the ICC's jurisdiction to TNCs. The second major problem with the idea of international criminal liability for TNCs is that imposing such liability would treat TNCs differently to states under international law. The International Law Commission (ILC) took several decades to draw up the Draft Articles, and in so doing it looked long and hard at the question of whether states could or should ever be subjected to criminal liability. The ILC eventually decided that state responsibility should *not* imply or entail criminal responsibility. Likewise and for similar reasons which are explored in Chapter 7, I argue that TNCs should be held accountable, but not criminally liable, when responsible for wrongful acts in their international activities.

Chapter 8 explores the important role of TNCs in the ecological future of the planet. The current state of international environmental law and environmental law enforcement is explored. There is currently a proliferation of environmental courts and tribunals around the world, but little coordination or consistency between them. Nor do they generally have any jurisdiction over TNCs, despite the often significant environmental impacts of TNC activity. At the UN level, despite the establishment of a specialized Environmental Chamber, the International Court of Justice (ICJ) has been hesitant, at best, when it comes to dealing with environmental issues. And while the Security Council has expressly recognized the security implications of global climate change,[23] it, too, has been mostly absent from the debate over the future international environmental obligations of states and other global actors. But these and other UN institutions could potentially play an important role in designing, monitoring and resolving disputes arising under future environmental law treaties. In Chapter 8 I would like to suggest that TNCs have a lot to offer to this process, as well as lot to gain from participating in it.

The final substantive chapter of this book examines the need for an international forum that could act as a final court of appeal in appropriate cases, in order to unify international jurisprudence relating to TNC responsibility. It is argued that an appropriately resourced ICJ would be well placed to accept this role.

The book concludes by stressing the importance of what the SRSG has called 'principled pragmatism' in bringing TNCs out of the accountability vacuum. The need for trust-promoting mechanisms to be in place when building the future of TNC global citizenship is also highlighted.

# B. EXISTING MODELS OF THE CORPORATION: PRIVATE VEHICLE OR SOCIAL ACTOR?

## 1. Common Law Models

Many commentators have noted the influence that the principal-agent model of the corporation has had on company law in Anglo-American legal systems.[24] This model is one which assumes that corporations are run well when directors (agents) make decisions 'in the best interests of' shareholders (principals). When directors fail to do this, inefficient 'agency costs' result. In order to overcome these agency costs, Anglo-American legal systems give primacy to the interests of shareholders, and impose obligations on company management to exercise their decision-making powers in 'good faith' and in a manner which furthers the best interests of the company.[25]

The generally accepted common law test defines 'best interests of the company' as essentially equivalent to the interests of the company's shareholders, or where a company is insolvent, its creditors.[26] It remains unclear, however, whether and to what extent directors are permitted to take into account the interests of other 'stakeholders', such as the company's employees, its suppliers, or those in the community affected by the company's activities. A narrow reading of the 'best interests of the corporation' rule could well make it illegal for business leaders to take such stakeholder interests into account – at least when those interests come into conflict with the need to maximize shareholder returns.[27]

The question of whether or not company directors should be permitted, or even required, to take into account the interests of specific stakeholders was examined in some detail during a series of investigations into company law initiated by the United Kingdom government since 1992.[28] The UK government eventually decided that such a requirement was necessary. Section 172 of UK Companies Act 2006 therefore now provides that:

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, ...

The UK government has also confirmed that pension fund trustees are not prohibited from considering social, environmental and ethical issues in their investment decisions, provided they act in the fund's best interests.[29] In both cases, however, it remains clear that promoting the success of the company or fund should remain the primary consideration in corporate decision-making.

The Australian Parliamentary Joint Committee on Corporations and Financial Services (JCCFS)[30] has also considered whether or not the Australian Corporations Act 2001 (Cth) (specifically its provisions dealing with directors' duties) is the right mechanism to address issues of corporate social responsibility (CSR).[31] In its report, released on 21 June 2006, the JCCFS found that:

> the Corporations Act 2001 permits directors to have regard for the interests of stakeholders other than shareholders, and recommend[ed] that amendment to the directors' duties provisions within the Corporations Act is not required.[32]

The Report also noted that ASX listing rules and other provisions in the Corporations Act already encourage various forms of CSR reporting by Australian-listed firms. For example, section 299(1)(f) of the Corporations Act, introduced in 1998, places an obligation upon directors to ensure that the company reports include details of the entity's performance in relation to any 'particular and significant' environmental regulation under a law of the Commonwealth or of a State or Territory. One effect of this requirement has been to encourage an increase in sustainability reporting by Australian-listed firms.

In rejecting an express requirement for directors to take CSR considerations into account, the Australian government reached a different conclusion to that reached in the United Kingdom. What both the UK and Australian governments have agreed upon, however, is that corporate social responsibility should remain essentially voluntary. Government might encourage and promote good corporate behaviour, but the market, rather than legal regulation, should be relied upon to guide business behaviour in socially and economically optimal directions. The committee's reliance on the 'business case' argument in support of CSR is made obvious through its various recommendations, such as its recommendation that:

> the Australian Government, in consultation with relevant sections of the business community, [should] undertake research into quantifying the benefits of corporate responsibility and sustainability reporting.[33]

The JCCFS also recommended the establishment in Australia of a new organization, the Australian Corporate Responsibility Network, modelled on the UK initiative Business in the Community, and charged with the job of

publicizing and promoting 'best practice examples across the spectrum of corporate responsible activities and across industry sectors'.[34]

Nearly all of the more ambitious legislative attempts to impose minimum standards on corporate conduct, however, have been notable for their lack of success. Examples include a Corporate Code of Conduct Act referred to the United States House Subcommittee on International Monetary Policy and Trade on 17 July 2000. A Bill was introduced to the First Session of the 107th Congress in 2001, but failed to pass.[35] In Australia, a Corporate Code of Conduct Bill 2000 was rejected by the Commonwealth Parliamentary Joint Standing Committee on Corporations and Securities, and thereafter was very quickly defeated when an attempt was made to introduce it into Parliament.[36] The draft Bill would have imposed environmental, employment, health and safety and human rights standards on the conduct of Australian corporations with large overseas operations.[37] It would not only have required corporations to report on their compliance with these standards, but would also have provided for enforcement through fines. More importantly, it would have provided a right for overseas communities and special interest organizations to take legal action against Australian TNCs to protect human rights. Remedies would have included both compensation and injunctions to prevent further damage.[38] Not surprisingly, the Bill received significant criticism and opposition from TNCs with operations in Australia – firms which exercise significant economic and political lobbying power in that country.

In June 2006, the reluctance of Australian authorities to even recommend, let alone impose, international standards on Australian firms became even more obvious. It was in that month that the Joint Parliamentary Committee investigation into corporate responsibility issued its Report concluding that it was premature even to adopt the Global Reporting Initiative Framework as a *voluntary* Australian sustainability reporting framework.[39] The Committee did not even consider whether or not the broader principles of the *Global Compact* should be incorporated into the Australian Stock Exchange Corporate Governance Council's voluntary Principles of Good Corporate Governance and Best Practice Recommendations.[40]

## 2. Civil Law Models

In contrast to the model of the corporation found in the United States, Australia and other Anglo-law jurisdictions, the German and other civil law legal systems ensure that stakeholder interests are expressly recognized in corporate decision-making. This is achieved essentially through two mechanisms: structural transparency of the corporate form, and participation by stakeholder interests in corporate decision-making. The aim is to ensure that

the benefits of the corporate form can be fully realized for customers, employees and the community, as well as for the shareholder.

In Germany, structural transparency and cooperation in corporate decision-making are facilitated by two main features: a two-tiered board structure and a system of co-determination. The two-tiered board system consists of the management or executive board and the supervisory board.[41] The members of the executive board manage the company and the supervisory board members control and monitor the management board. The supervisory board may, *inter alia*, examine the business decisions made by the management board and may examine all financial statements and accounts. Independence of the supervisory board is maintained by legislation which provides the two boards with totally separate functions. The system of co-determination operates through the structure and mechanisms of the supervisory board. By requiring that a certain proportion of supervisory board members must be employees, the system ensures that the supervisory board provides a mechanism through which employee representatives can safeguard employee interests.[42]

Another way in which the German system operates to promote a working relationship between management and labour is by requiring consultation and agreement between employer and works council at establishment level with regard to any 'co-determination matter'. Thus, to take action relating to a co-determination matter in terms of the Works Constitution Act 1972, employers must first obtain the consent required to do so from the works council. Any unilateral action on the part of the employer becomes void and unenforceable in the absence of works council consent. When the employer and the works council cannot come to agreement on a co-determination matter, the matter is referred to an arbitration committee (*Einigungsstelle*). Any decision made by the arbitration committee is binding on both sides.[43]

Finally, a mention should also be made of employee share ownership schemes, which have become common in Europe in the 1990s. While it remains true that penetration of employee shares in Germany is much lower than in the United States and Britain, the potential for employees to exert financial as well as supervisory influence in shaping corporate decision-making is one which could well be realized in future.[44]

Within the Asia-Pacific region, the civil law tradition has provided the basis of the Indonesian legal system (inherited from the Dutch) and, to a very large extent, the Chinese legal system as well. As in Germany, the Chinese Company Law 2006 mandates a dual-board structure for listed corporations.[45] There must be both a board of directors and a supervisory board of not fewer than three members. At least one-third of the supervisory board must comprise workers' representatives who must be democratically elected by the company's employees.[46] Employees of large Chinese firms are also increasingly able and willing to exercise a voice through share ownership incentive schemes.[47]

Japanese corporations have also traditionally been characterized by an 'insider system of corporate governance', though of a uniquely Japanese nature. Although no longer a mandatory requirement of Japan's Companies Act,[48] most large corporations in Japan have traditionally had a dual structure: a board of directors, which carries out the functions of strategic decision-making; and the board of auditors, which audits management's execution of business activities.[49] Most large Japanese companies also have unions and joint committees with access to senior management. Thus, employees are important stakeholders and management mediates between the shareholders, employees and other stakeholders.[50]

What is needed now is a closer examination of the relationship between key features of different corporate decision-making structures, on the one hand, and the propensity of the corporation to incorporate social, environmental and human rights concerns into the making of business decisions. To what extent do features like the two-tiered board, employee representation on the board, employee share ownership and other features impact on the social responsibility record of corporations? Do companies with a certain type of governance structure have a better record of 'social responsibility' than other companies? Certainly a quick survey of participants in the Global Compact, perhaps the most ambitious project aimed at promoting 'corporate social responsibility' to date, shows that the number of participating TNCs based in Anglo-American company law systems is roughly the same as the number from European-style company law systems.[51]

## C. TAKING CORPORATE RESPONSIBILITY SERIOUSLY: REGULATORY REQUIREMENTS

The traditional 'shareholder primacy' view of directors' duties in corporate law is largely based on the idea of directors as agents of the shareholders of a company. However, the changing role of corporations in society has caused this view to be questioned with increasing force in recent times. As Bryan Horrigan has pointed out, shareholder primacy thinking is predicated upon a 'zero-sum game' between the interests of shareholders and the interests of other 'non-shareholder stakeholders'. This is far from the reality of the modern corporation, where shareholders often have an extensive commonality of interests with other stakeholder groups.[52] A number of recent measures introduced into the laws and listing regulations of many nations have recognized this reality. Such measures have resulted in the express recognition of non-shareholder interests in the Annual Reports of public companies around the world, and have coincided with increased media coverage of, and academic interest in, issues of corporate responsibility.