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**A Reformed Global Legal Architecture for Corporate
Responsibility**

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Abstract

A Reformed Global Legal Architecture for Corporate Responsibility

This paper considers key features within the legal architecture of all jurisdictions that utilise the ‘corporation’ as a primary medium for business enterprise. Therefore it highlights the legal frameworks under which ‘corporations’ operate and the pressure that this places upon corporate directors to achieve specific financial outcomes. It then illustrates how this legal architecture can have certain negative effects for other stakeholders such as the environment and communities.

The paper considers the reasons why the law was originally designed in this manner and seeks to demonstrate that this design represents one of the ‘drivers’ of environmental degradation and greenhouse gas emissions, which in turn affects peoples’ human rights.

It takes into account the initiatives that have developed in recent years, which include the work of the UN’s Special Representative of the Secretary General - Professor John Ruggie, the work of the Global Reporting Initiative and the development of the concept of ‘corporate social responsibility’. It assesses the effectiveness of these initiatives and questions whether they address the ‘root causes’ of the problem that they look to resolve.

Finally, consideration is given to recent research which has proposed a new type of legal architecture, that would provide a framework of legal responsibilities for corporations to adhere to within an international system of administrative oversight. This redesigned legal and administrative framework would necessitate that all business activity would be predisposed to outcomes of environmental sustainability.

1. Introduction

This paper considers the design of the corporation as a legal entity with a view to analyzing exactly how that design can predispose it to cause environmental degradation. Having considered this design and the legal architecture that it resides within on an international level, the paper considers the design reforms that would be required to ensure that the outcome of all business and industry (undertaken by corporations) would be one of environmental sustainability. The paper therefore is made up of two distinct parts. The first part considers the design features within the law and the second part considers the reforms that would be required to remedy those design features.

The paper begins with an analysis of the legal developments that led to the evolution of the modern corporation to understand the logic of certain legal features contained within its overall design. It goes on to explain how this design has been adopted in the majority of jurisdictions creating a truly global framework of law. However, it also notes that the design was formulated long before contemporary awareness of environmental degradation and at a time when the world was very different in terms of its global trade and international institutions.

The paper considers how the legal design that is described, has impacts upon the environment and the way that corporate directors are obliged to operate in accordance with specific legal obligations rather following personal preferences or the demands of ecological imperatives. It considers the responses of the international community to the outcomes of this legal design and explains why they are limited in their effectiveness. Therefore it considers responses such as the concept of ‘corporate social responsibility’, codes of conduct, corporate reporting and the ‘Ruggie Guidelines’ (UN Human Rights Council 2011).

The second part of the paper considers a redesign of specific aspects of the law relating to corporations with a view to ensuring that their functioning is predisposed to achieve environmental sustainability. It therefore considers the design features that would be required within corporate law and the institutions that would be required on an international level to achieve this. Finally, it comments on how such a redesign could play a significant part in climate change mitigation.

This analysis forms part of a wider analysis of the global legal architecture and the design features within it that lead to environmentally unsustainable outcomes (Turner 2014, 31-69). Therefore it is part of what could be called ‘macro legal analysis’. In other words, analysis of legal systems as they function together rather than legal systems or parts of legal systems in isolation. The overall purpose of this type of analysis is to identify those aspects of legal systems which operate on a global level (and hence can be described as part of the ‘global legal architecture’) which predispose the functioning of business, industry and states to unsustainable outcomes. This type of analysis seeks to identify the ‘root causes’ of environmental degradation (Bodansky 2010, 10) and develop appropriate legal and institutional responses to them.

2. Design Features

Analysis of corporations, as they relate to the environment, requires an understanding of the way that they developed historically and why specific design features were included in their make up as legal entities. It is also important to identify how those design features, operating either individually or in conjunction with each other, can lead to detrimental outcomes for the environment.

The earliest corporations, in terms of the type of legal entities that contained the design features that are still fundamental to contemporary corporations, were developed in the late 1700's following the War of Independence in the United States and then in the early 1800's in Europe (Henn and Alexander 1983, 25; Gower 1979, 41). The core elements of those early corporations were then replicated throughout the world. This resulted in corporations around the globe that included four design features that would have a direct effect on the manner in which they would impact the environment from that day to this. Those features were: that corporations were designed with separate legal personalities to their shareholders, that the shareholders usually enjoyed limited liability, that their directors (or the main decision-makers) had specific duties to promote the interests of the corporation, and that their directors would face serious sanctions in the event that they failed to carry out their responsibilities to the corporation (Turner 2014, 39-47). These features were built into the design of early corporations to stimulate investment in business ventures and to protect the interests of the shareholders. They were fundamental to a legal construct that became an extremely successful medium for business and has been particularly effective for large businesses operating in more than one jurisdiction (UNCTAD 2014, ix).

The feature of separate legal personality meant that the debts of a corporation were *prima facie* separate from the debts of its shareholders and also that corporations did not cease on the death of one or more of its shareholders (Garvin, Frisby and Hudson 2010, 7). Separate legal personality on its own however, did not protect the shareholders from all liability in the event of a business failure, therefore the inclusion of the feature of limited liability meant that corporations had been designed in a way which encouraged individuals to speculate, with the knowledge that their own personal liability would be limited in the event of business failure (Gevurtz 2000, 27).

As corporations were designed in such a way that the directors were not always the same people as the shareholders, there was always a danger that the directors of corporations could misuse the shareholders' funds, especially if there was a lack of oversight by the shareholders (which was the case for many large corporations). Therefore another logical design feature developed within the constitutional make up of corporations known as "directors' duties", which ensured that the directors of corporations were bound to use their powers in a manner which would bring financial benefit to the shareholders, and not serve either their own, or any outside interests (Davies and Worthington 2012, 503; Henn and Alexander 1983, 612). This was compounded by another design feature, which was the imposition of extremely strict

sanctions for those directors who failed to comply with those duties. These specific features afforded protection to the shareholders and led to a fluid environment in which funds were readily invested in corporations and as such the corporation as a medium for business became an accepted fixture in modern economies (Turner 2014, 41-44).

Whilst there was an inherent practical logic for the inclusion of these design features, which has been borne out by the success of the corporate form, there have been side effects, which could not have been envisaged at the time of their inception. In the 18th and 19th centuries, concerns for the environment were obviously not paramount, if present at all in the contemporary sense. Therefore the design feature of “directors’ duties” that protected investors, meant that directors of corporations were legally obliged to place the interests of a corporation or its shareholders ahead of other interests, so long as the operations of the business were lawful. As shareholders inevitably invest money in corporations to make a profit either through dividend payments or through increases in share values, the duty that directors have to further the interests of the corporation have naturally been interpreted as a duty to protect and further the financial interests of the shareholders (Turner 2014, 41-44).

What this has ultimately meant is that directors of corporations are legally obliged to make decisions that are in the best interests of the corporation and not necessarily in the best interests of the environment. It also means that directors who fail to comply with this responsibility face the consequence of heavy sanctions, which in some jurisdictions can include criminal sanctions but in practice often means that they can lose their jobs (Turner 2014, 41-44). Therefore it can be said that where any corporation causes harm to the environment in the process of making a profit, so long as it and the directors have acted lawfully, the directors will have complied with their “directors’ duties”.

What is interesting to note when the corporate law of different jurisdictions worldwide are compared, is the way that the aforementioned legal structure has been so comprehensively replicated. Therefore those specific design features can be seen not only in those jurisdictions in which they originated such as the states of the USA (Backer 2002, 1129) the UK (Villiers 2010), France and Germany (Andenas and Woolridge 2009, 283) but as a result of processes of colonization, transplantation and globalization, in states right around the world with backgrounds as diverse in character as China (Turner 2014, 44), Japan (McAlinn 2007, 109; Kanda and Milhaupt 2003, 887) and Peru (Turner 2014, 44). Therefore straightforward design features that were included within the corporate form two centuries ago, for perfectly sound business and economic reasons, have gone on to have far reaching ramifications for the environment worldwide (Sjåfell 2012).

There are two further features of the operation of corporations on the international level which have far reaching ramifications for the environment. These are firstly, that corporations are currently only registered within the jurisdiction in which they operate (Muchlinski 2007, 45-79) and secondly, that international law does not apply directly to them (Clapham 2013; Knox 2008).

The first of these features means that when a corporation sets up a subsidiary in another jurisdiction, it has to register that subsidiary as a corporation in that other jurisdiction and the subsidiary will technically be a separate legal entity to the parent corporation (Ruggie 2013, xxxiii). As a separate legal entity to the parent corporation, it can be difficult to make the parent corporation liable for harm caused by the subsidiary; this is especially the case where the subsidiary is operating in a jurisdiction in which there is poor governance and a lack of enforcement of environmental regulations. There are countless examples of severe levels of environmental degradation that have been caused by the activities of corporations under those circumstances (Dine 2012, 47). This legal architecture combined with the responsibility that corporate directors have to maximize the financial interests of the corporation has clearly had widespread impacts upon the environment. Whilst there have been lawsuits in certain extreme cases which have attempted to circumvent this framework and make the parent corporations accountable, the successes have been limited and the overall framework is still significantly wanting (Turner 2009, 124-7). It is a type of legal framework that enables corporations to take advantage of differing environmental standards in different parts of the world and also the differing capacities of local communities to seek and bring about legal redress when harm is caused.

The second feature relates to the relationship that corporations have with international law. Clearly the fact that corporations are not subjects of international law means that they cannot be directly held accountable for the consequences of their operations under international environmental law or international human rights law (Clapham 2013). Therefore, in addressing the consequences of the operations of corporations *vis à vis* human rights and the environment it is important to consider reforms not just to corporate law but also to the functioning of international law, if environmentally sustainable systems are to be achieved.

3. The International Community's Response to those Design Features

The response of the international community to the design features that have been described has raised awareness of the issues, led to greater public scrutiny and in some cases led to direct redress. In general terms there have been initiatives from the business and investment community itself, from civil society, from international organizations other than the United Nations (UN) and also from the UN itself. However, overall the responses of the international community have failed to achieve a shift towards a business model in which environmental sustainability is an inevitable consequence of the functioning of corporations. As such corporations still play a significant role in the degradation of the environment and of course the impacts upon peoples' human rights that result from it. It is argued that the reason for this is because the initiatives that have been taken have been responses to the symptoms of the problems rather than responses to the actual design features or 'root causes' of the problems themselves (Turner 2014, 68). As such they fall short of fully addressing the underlying legal frameworks that cause decision-makers within corporations to make decisions in a specific way and they do not attempt to introduce a comprehensive system of oversight under

international law. However, they must be viewed within their historical and socio-political contexts and in that light can be seen as having catalyzed a step-by-step change and stimulating a broader debate, which has paved the way for more contemporary approaches.

An example of an initiative by the business and investment community was that taken following the oil slick that occurred when the Exxon Valdez tanker ran aground in the Prince William Sound of Alaska in 1989. A group of investors set up the Coalition for Environmentally Responsible Economies (CERES). This group subsequently drafted a set of principles that corporations could follow in the manner in which they carried out their business operations (Smith 1993).

Since the 1960s responses from civil society have steadily increased awareness relating to the harm that has been caused to the environment by corporations. This has led to the evolution of extremely sophisticated NGOs that place pressure on corporations, instigate legal action relating to environmental harm and pressurize governments to exert greater control. In more recent years civil society groups such as the Global Reporting Initiative (GRI) have developed reporting frameworks that corporations can follow to bring about transparency relating to the impacts that they have upon human rights and the environment. An increasing number of corporations are using such reporting frameworks as part of their own policies to integrate 'sustainability' into their business practices (Benn, Dunphy and Griffiths 2014, 74).

The Organization for Economic Cooperation and Development (OECD) took a leading role in 1976 by developing guidelines for multinational enterprises (MNE) to follow. The most recent version was published in 2011 (OECD 2011). These guidelines are drafted in quite vague terms and are non-binding. However, they do represent a further acknowledgement by the international community of the negative impacts that can be caused by the operations of corporations.

Last, but by no means least, there are the initiatives that have been taken by the UN itself. For example, in 2000 the UN launched the 'Global Compact' (UN Global Compact), which provided a set of principles for corporations to follow. It specifically addressed the environment in principles 7, 8 and 9. Corporations are able to subscribe to the 'Global Compact' and post the steps that they have taken to address associated issues on its website.

The most recent initiative within this field has been the work of Professor John Ruggie as the 'Special Representative of the Secretary General on the issue of human rights and transnational corporations and other business enterprises'. Professor Ruggie's work resulted in a number of reports, the final one being published in 2011 (UN Human Rights Council 2011). It advocated three principles upon which the protection of human rights *vis à vis* the impacts from business should be founded. These were firstly that states should 'protect' human rights, secondly that corporations should 'respect' human rights standards and thirdly that appropriate mechanisms should be in place to facilitate remedies for the victims of human rights violations. The ongoing work that has resulted from what have become known as the 'Ruggie Guidelines', has been the development of criteria of 'due diligence' that

corporations should carry out to attempt to ensure that their operations do not impact negatively upon peoples' human rights (Ruggie 2013, 99; Mares 2012).

The aforementioned represent some of the main initiatives that have been instigated by the international community. They provide a representation of the type of work that has been carried out and the emphasis that has been placed upon voluntary guidelines that encourage corporations to conduct their business with certain principles in mind. All of these initiatives have made significant advances in this field, however they have certain factors in common.

Firstly, they rarely fully address the critical nature of the legal 'duties' of directors. As such they generally do not fully address the fact that "directors' duties" represent hard law and that when directors of corporations are faced with the dilemma of whether to follow those duties or soft law of codes of conduct and guidelines, the majority of directors will inevitably choose to follow the hard law.

Secondly, the codes of conduct and guidelines that have been mentioned do not adequately address the critical issue of the nature of the registration of corporations that work together as MNEs. Therefore as an example, they do not find a solution to the practical reality of subsidiary corporations being formed (as separate legal entities) within the jurisdictions in which the parent corporation seeks to operate. As has been noted, this creates tensions when communities find it difficult to achieve redress following negative human rights and environmental impacts (Dine 2012, 47).

Thirdly, it can be argued that codes of conduct and guidelines, through their voluntary nature do not adequately provide an institutional framework within which standards of environmental protection and human rights can be guaranteed, whatever jurisdiction they operate in. Therefore, although they do encourage standards for corporations to follow, they are often vague in their content and lack enforceability (Shelton 2003, 218).

It is noteworthy that Professor Ruggie himself commented on the weakness of voluntary initiatives but stated that,

'[t]here is little chance of transnational firms becoming subject to legally binding regulations at the global level any time soon; the political will or even capacity simply is not there, and much of the corporate world would unite to fight it. In contrast, *voluntary initiatives over time may build an interest among leading firms for a more level playing field vis-à-vis laggards*, thereby realigning the political balance in the corporate sector.' (Ruggie 2004, 518).

From this real world perspective, the argument has been that it is better to make at least modest progress through soft law, which is acceptable to the corporate world, than to attempt more ambitious reforms that may never be realized. However, it can equally be argued that a long-term plan that ultimately leads to real environmental sustainability needs to be developed. It can also be argued that such long-term reform should be based upon addressing the underlying 'root causes' of environmental degradation. The subsequent section discusses

reform proposals that have been put forward to address the design flaws in the existing system that can be seen as constituting some of those ‘root causes’.

4. A Redesign of the Existing System

The foregoing commentary leads to the suggestion that there is a need to create a legal system that is designed to ensure that environmental sustainability is the inevitable outcome of any business and commerce. Therefore the type of reform outlined in this paper envisages not only the creation of reformed legal obligations but also the development of mechanisms that would enable those obligations to be fulfilled, within a reformed institutional framework that would ensure that the system could function efficaciously and equitably. These reform proposals have been elaborated as part of a draft framework treaty – the draft Global Environmental Right (draft GER) (Turner 2014, 70). The draft GER seeks to address some of the main deficits within the existing global legal architecture relating to environmental governance. The following sub-sections are limited to focusing on its proposals in relation to corporations.

4.1 The Institution of an International Corporation Registration Body

It has been noted that within the existing global legal architecture, corporations are usually only accountable in the state in which they are registered and operating (Ruggie 2013, xvi). The draft GER contains provisions that would overcome this by making corporations that ‘operate internationally’ not only directly subject to national laws but also to international environmental standards.

As such the draft GER includes in Art. 12 provision for the creation of an International Corporation Registration Body (ICRB). This would act as a registry and licensing body for all corporations that ‘operate internationally’ (Turner 2014, 75). In other words corporations that either buy or sell to customers located in other countries, or which have subsidiaries in other countries, or which are the subsidiary of a parent in another country, or that are part of a consortium of companies operating on an international basis, would be required to be registered with this body. This would mean that in the event that a corporation failed to comply with the requisite environmental and human rights standards, the ICRB would have the power to impose appropriate sanctions accordingly (Art. 12(c)). Ultimately the ICRB would have the capacity, in extreme cases, to withdraw the license of a corporation (Art. 12(d)). This system would provide the basis for a level playing field for all corporations in the international arena.

4.2 An Intrinsic Duty of Corporations to Avoid Causing Harm to the Environment

As has already been emphasized, a key part of the fabric of the global legal architecture that has a major impact upon the environment is the duty that directors have to promote the interests of corporations, which can mean that the financial interests of corporations are quite legitimately promoted at the expense of the environment. To deal with this specific feature, the draft GER contains a number of provisions that would institute duties for corporations to ensure that the environment is protected within a framework of international institutional oversight.

The obligations to which corporations would be required to comply, are based on an overarching provision found in Art. 1 that would place a duty on all decision-makers to protect the environment. There are two points relating to this provision that can be made at this stage. Firstly, it represents a departure from the traditional Westphalian approach of international law, as it speaks directly to ‘non-state’ as well as ‘state’ actors. Secondly, it is drafted to include an obligation that would require any actor, (that ‘will’ or ‘may’ cause degradation to the environment) to compensate the environment itself for any actual degradation caused or insure the risk of potential degradation. In this manner it contains a mechanism to achieve ‘no net loss’ (Salzman 2005, 908; Achterman and Mauger 2010, 306) or ‘ecological impact neutrality’ (McGillivray 2012, 417-8) or in other words a form of environmental sustainability.

The specific manifestation of Art. 1 in terms of its application to corporations is detailed in Art. 7. This would require corporations to purchase offsets for any environmental degradation that ‘will’ be caused by their operations (Art. 7 (c)). Additionally, to ensure that operations that ‘may’ cause degradation to the environment are also covered, Art. 7(d) would require that corporations purchased adequate environmental insurance. The use of offsets for the protection of the environment is certainly not a perfect antidote for environmental degradation and as such has drawn much criticism (McGillivray 2011; McNish 2012; Matthews and Endress 2008). However, their use has gained traction and alongside adequate environmental impact assessments, they provide a method of ensuring that environmental externalities are internalized within operations undertaken by business and industry (Reid 2011).

4.3 Duty of Corporations to Maintain Environmental Accounts

It was also noted in section 2. that as a result of the global legal architecture, corporations are not usually accountable on an international level but on a national level in the jurisdiction in which they are registered. The disadvantages of this system and the potential for extensive environmental degradation have been widely acknowledged (Dine 2005, 47). It is argued that to develop a comprehensive framework of accountability, a key component would be a system of reporting that was tied to an institutional structure that could impose appropriate

sanctions. Such a system would be a progression from the type of environmental reporting which has already developed but which is largely voluntary in nature (Tully 2012, 140-5).

The system of reporting that is included within the draft GER is found in Art. 8. This provision would require corporations to lodge environmental accounts annually (Art. 8(a)). Each corporation would be required to ensure that such accounts were made available to the public in the same manner as their financial accounts (Art. 8(b)).

The standard of environmental accounting is also provided for; Art 8(c) states that environmental accounts would be required in a form which was consistent with that prescribed by a World Environment Organization (WEO), which is discussed in the following section. Additionally, Art. 8(d) would require that all corporations submitted a copy of their environmental accounts to the WEO which would have the task of ensuring that they were consistent with the specific standards.

4.4 The Role of the World Environment Organization (WEO) in relation to Corporations

The concept of a World Environment Organization is one which has received much critical attention over the last two decades. To some proponents the concept has been a response to a lack of compliance of international environmental law treaties, to others it has been seen as a necessary balance to the influence of the WTO, to others it has been an answer to the fragmented nature of international environmental law and to others it has been suggested as a political focal point for the progression of environmental issues on an international level (Goeteyn and Maes 2012; Charnovitz 2005; Esty 1994). However, whatever perception of a WEO has been put forward, it has received mixed responses and significant opposition (Najam 2005; Moltke 2005). The type of WEO that is proposed within the draft GER builds on some of the earlier proposals and anticipates a formalized role in providing the necessary oversight of corporations.

Therefore the draft GER suggests that a WEO should receive corporations' environmental accounts to ensure that they were consistent with specific standards (Art. 13(e)). It would also receive the reports of the registered suppliers of environmental offsets and environmental insurance with the task of ensuring that they too complied with necessary standards (Art. 13 (b)). It would also make recommendations to the ICRB when corporations fell below the standards required, in order that appropriate sanctions could be applied.

5. The Effect of Such Reforms on the International Climate Change Regime

The overall effect of the draft GER in reforming the global legal architecture as it relates to corporations would be twofold. Firstly in terms of corporate law, it would create a legal obligation for corporations to protect the environment, which was not originally included in

the design of the law in the late 18th and early 19th centuries. Therefore it would be a departure from a long held tradition, but as this paper argues, a necessary departure. Secondly, the proposed system of oversight and accountability would represent a marked contrast to the existing lack of direct application of international human rights law and international environmental law to corporations.

Therefore it is pertinent to consider what such a framework would ultimately mean in terms of developing a renewed international climate change regime (Turner 2014, 101-115). There are three key points that should be noted. Firstly, by making corporations directly accountable under an international regime for the environmental degradation that they cause (including their GHG emissions), states themselves would share the burden rather than being solely responsible for climate change mitigation. Secondly, by creating a direct responsibility for corporations to operate to a standard of ‘no net loss’ to the environment, a requirement would be introduced into business and commerce that was designed to pave the way towards the levels of GHG emissions that the IPCC anticipates would be required by 2100 (IPCC 2014, 13). Thirdly, by creating a WEO and an ICRB to which corporations would be accountable, it would be possible to introduce the application of equity across sectors using Art. 18 of the draft GER to incorporate ‘transitional arrangements’.

Therefore it can be argued that overall the advantages to the international community of adopting such a system would be that it would distribute the burdens of climate change mitigation more logically and fairly. Additionally, this type of re-distribution of responsibilities could leave states in a much stronger position to work together to deal with the challenges of climate change adaptation.

6. Conclusions and Policy Recommendations

What this paper has shown is that there are deficits in the design of corporate law that can be traced back to its origins in the late 18th and early 19th centuries. It has demonstrated that the original design was very logical and that it would have been impossible for those early founders to have envisaged the side-effects of its operation in the 20th and 21st centuries. It has also shown that the necessity for directors of corporations to make decisions, which ultimately benefit the corporation, has led to corporate law around the globe that is dysfunctional in terms of the relationship that corporations have with the environment and the expectations of the international community. It has emphasized that many of the responses by the international community to environmental degradation caused by corporations, have only been moderately successful because they have not addressed the ‘root causes’ or underlying ‘drivers’ of such degradation, which are found in the law itself rather than in the conduct of corporate decision-makers.

It has put forward the reforms that have been suggested as part of the draft GER as a way of achieving environmental sustainability in the operations of corporations. The proposed reforms include systems of accountability that would make corporations that ‘operated

internationally' directly accountable on the international level, rather than solely on the domestic level which is currently the case. It also suggests that if the type of global legal architecture that the draft GER envisages were to be adopted, the renewed system of accountability for corporations would lead to a major component in the international community's work to address anthropogenic GHG emissions.

There are two main policy recommendations that stem from this paper. Firstly, further work should be undertaken to consult with potentially affected stakeholders, including governments, corporations, international institutions and civil society with a view to gaining a clearer picture of the opportunities and challenges that these reform proposals represent. Secondly, further work should be undertaken to build a clearer picture of the way that the suggested reforms could operate in practice.

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