

# The Promotion of Corporate Social Responsibility in English Private Law

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## **Declaration**

I declare that this thesis is my own work and it has not, in whole or in part, previously been presented by me to this or any other university for the conferment of any degree.



## **Abstract**

The thesis rests on the argument that the literature on Corporate Social Responsibility (CSR) and the law has, so far, largely neglected the contribution that private law makes or could make to the promotion of CSR. The primary research question of this thesis is therefore to analyse the extent to which English private law already promotes and/or could better promote CSR.

Based on the analysis of four substantive areas of private law (company law and corporate governance, contract law, consumer law and tort law), one of the overall contributions of this thesis is to demonstrate that private law plays an important role in the regulatory framework of CSR. Whilst this analysis shows that there are limitations in the promotion of CSR in English private law, it is argued that private law already makes an important contribution to the promotion of CSR. Moreover, it could make an even better contribution if some of its limitations were addressed.

The analysis in the substantive chapters demonstrates the different ways in which private law promotes CSR: First, CSR is, at least in part, law. Secondly, private law provides mechanisms to incorporate and to enforce CSR commitments. Thirdly, private law contributes to hybrid regulatory approaches to CSR, i.e. systems where different forms of regulation such as private law, public law and soft law standards interact. The thesis demonstrates that the effectiveness of the regulatory system in promoting CSR can be enhanced by regulation through public and criminal law of companies in their home state, in combination with national private law. However, if private law were to make an even better contribution then some changes would be needed to the areas of private law analysed in the substantive chapters. The thesis will therefore conclude with a list of substantive recommendations for changes to English private law.



## **Acknowledgments**

This PhD has its origins in an interest in the role of business in society that I developed during my Masters studies at the University of Sheffield in 2004-5. I was particularly intrigued by the differences in the regulation of companies in English law and German law and discussions I had with Andrew Johnston during that year. Following the LLM, I qualified as a German lawyer and I looked at companies from a rather practical legal perspective. However, when I was given the opportunity to run the LLB Law with German degree at Sheffield in 2008, I was keen to use my job at the University in order to work on a PhD that addresses my interest in companies.

In the meantime, the new Companies Act 2006 had been enacted. Its underlying enlightened shareholder value theory naturally caught my interest. Moreover, the concept of Corporate Social Responsibility (CSR) had gained prominence in the public debate. When I returned to the issue of the regulation of companies and the relationship of the company with its various stakeholders, I noticed that there was a substantive body of literature on CSR in international law and in socio-legal studies. Upon reflection, I wondered what the contribution of private law could be to the promotion of CSR. This interest led to the development of the PhD in its scope which looks at CSR from the perspective of different substantive areas of private law, not just company law and corporate governance, but also contract law, consumer law and tort law.

The research and the writing of the PhD would not have been possible without the help of many people. My supervisors Duncan French, Tammy Hervey and Veronica Ruiz have been exemplary throughout the whole process and I would like to thank them all for their support, guidance and hard work. Duncan French, as my initial first supervisor, encouraged me to develop my ideas from the beginning and I have strongly benefitted from discussions with him. He continued to take an active interest in my research for this thesis since he has left Sheffield. Tammy Hervey as my academic mentor was brave enough to take over the role as first supervisor when I was in the process of writing up the thesis and I am very grateful for that. The change of first supervisor was thus a very smooth transition. I benefitted immensely from discussions with her. I know that I would not have been able to finish this work by now without her incredibly prompt feedback on chapters and the time plan that forced me to balance my full-time job with the demands of finishing the PhD. Veronica Ruiz, as my second supervisor, has seen the process of working on this thesis from the beginning to the end and she, too, has been extremely helpful and supportive throughout.

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# Chapter 1: The aims and the scope of the thesis

## 1.1 Private law and Corporate Social Responsibility

The public concern about the impact of corporations on, for instance, the environment and their employees has increased in the wake of the global economic and financial crisis. This crisis has strengthened the interest in the concept of Corporate Social Responsibility (CSR).<sup>1</sup> Many corporations have adopted CSR standards pledging to conduct business in a responsible manner.<sup>2</sup> The engagement of companies with CSR is partly due to the negative reputational effects of reports about irresponsible conduct of companies, for example human rights violations committed by the subsidiaries and suppliers of Western companies in the developing world such as the use of child labour or excessive working hours.<sup>3</sup> CSR has also become an important issue on the political agenda. The UN has given prominence to CSR through the work of Professor John Ruggie from Harvard University who worked as Special Representative on the issue of human rights and business (SRSG) until 2011.<sup>4</sup> Upon completion of his mandate, he published the UN Guiding Principles on Business and Human Rights which were called 'a landmark in the CSR debate'.<sup>5</sup> Moreover, the EU Commission has recently published a communication on CSR which contains an action agenda for the period 2011-2014.<sup>6</sup>

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<sup>1</sup> The debate surrounding the definition of CSR will be discussed in the second chapter. This thesis uses the following definition of CSR by Campbell and Vick: 'At a minimum the term implies an obligation on the part of large companies to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders but also employees, consumers, suppliers, creditors and local communities. These interests are not just economic, but also include environmental, human rights and 'quality of life' concerns. The obligation to be socially responsible is usually conceived of as being over and above the minimum requirement imposed on companies by formal legal rules, although this is not invariably the case.', see: K Campbell and D Vick, 'Disclosure Law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 242.

<sup>2</sup> A study published in 2010 shows that 77 out of the 100 constituent FTSE100 firms had adopted codes of conduct which contain the CSR commitments of the companies. See: L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 475.

<sup>3</sup> C Soosay, A Fearn and B Dent, 'Sustainable value chain analysis – a case study of Oxford Landing from "vine to dine"' (2012) 17 *Supply Chain Management: An International Journal* 68.

<sup>4</sup> The website of the Special Representative of the Secretary-General on human rights and transnational corporations and other business enterprises gives a useful overview about the work done within the mandate, available at: <http://www.business-humanrights.org/Home> (last accessed: 09/04/2013).

<sup>5</sup> J Ames, 'Taking responsibility' (2011) *European Lawyer* 15. For the Guiding Principles see: Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, 21<sup>st</sup> March 2011, available at: [http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf) (last accessed: 01/04/2013).

<sup>6</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and social committee and the committee of the regions: A renewed EU strategy 2011-14 for Corporate Social Responsibility' COM (2011) 681 final, available at:

In February this year, the EU Parliament adopted two resolutions on CSR in which it highlights the importance of company transparency on environmental and social matters.<sup>7</sup>

Different academic disciplines such as Management Studies, Economics, Politics and Law analyse CSR from a range of perspectives and methodologies. However, the link between law and CSR remains unclear and contentious. Particularly business leaders continue to understand CSR as going beyond legal requirements.<sup>8</sup> This understanding is often based on the fact that a great deal of CSR activity is self-regulation, such as private CSR standards which are, inter alia, developed by corporations themselves or private actors (e.g. NGOs), sometimes acting alone, and sometimes in conjunction with corporations.<sup>9</sup> Much of the legal literature has focused on international law, for example by analysing the role of the UN or the OECD.<sup>10</sup> The literature on CSR and the law has, so far, largely neglected the contribution that private law makes or could make to the promotion of CSR. However, private law plays an increasing role in relation to CSR, for instance, through the incorporation of these private CSR standards into business relationships (e.g. contracts), the duty for directors to promote the success of the company for the benefit of its members as a whole in s172 (1) Companies Act 2006 and the liability of companies for violations of CSR principles in tort. The underlying primary research question of this thesis is, therefore, to analyse the promotion of CSR in English private law.<sup>11</sup> With its private law perspective, this research shall contribute to filling this gap in the existing literature on CSR and the law.

This thesis focusses on private law for four reasons. First of all, as indicated, the existing literature on CSR and the law has primarily concentrated on international law. So far, private law seems to have been largely sidelined despite its increasingly

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[http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index_en.htm) (last accessed: 09/04/2013)

<sup>7</sup> The resolutions passed on 6<sup>th</sup> February are: First, Report on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth (2012/2098(INI)); Committee on Legal Affairs, available at:

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0017+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013); Secondly, Report on Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery (2012/2097(INI)); Committee on Employment and Social Affairs, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0023+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013).

<sup>8</sup> See The Confederation of Business Industry (CBI), available at:

<http://www.cbi.org.uk/ndbs/content.nsf/802737AED3E3420580256706005390AE/9D502144AC9F644380256F58005BD16C> (last accessed 03/10/2012).

<sup>9</sup> R Mushkat, 'Corporate Social Responsibility, International Law, and Business Economics: Convergences and Divergencies' (2010) 12 *Oregon Review of International Law* 55.

<sup>10</sup> Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 27.

<sup>11</sup> The term 'promotion' is discussed in section 1.2 of this thesis.

important role for the legal regulation of CSR, for example in company law. Secondly, whilst much of the literature on CSR and the law is interdisciplinary and/or based on socio-legal perspectives (e.g. reflexive governance which is a process-oriented legal theory that looks at the learning and exchange of different social subsystems)<sup>12</sup>, the focus here allows an in-depth analysis of the existing and possible legal effects of CSR in English private law in order to contribute a legal perspective to the ongoing discussion about CSR and the law. Thirdly, the CSR instruments of international governing bodies, such as the UN, are predominately soft law recommendations and guidelines, whereas private law provides individuals with remedies for breach of their rights. Private law could therefore be a tool to legally enforce CSR commitments. Fourthly, the UN Guiding Principles emphasise the importance of home state regulation of multinational corporations.<sup>13</sup> The home state is considered to be the state in which the multinational corporation is incorporated.<sup>14</sup> In contrast, the host state is the state in which the multinational enterprise, either directly or through its subsidiary, operates.<sup>15</sup> The focus on home state regulation in the Guiding Principles suggests that national private law, which is closely linked to national legal systems, could play an important role for the future regulation of CSR.

Against this background, the thesis will analyse four areas of private law which have been chosen due to their relevance for the promotion of CSR. These areas are: First, company law and corporate governance; secondly, contract law; thirdly, consumer law; and fourthly tort law. Company law and corporate governance are the basis for the CSR engagement of companies, for example, through directors' duties or reporting duties. Contract law is used here as many companies incorporate their CSR commitments into their supply chain contracts, for example, the contracts that an English company forms with its suppliers that are based abroad. Moreover,

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<sup>12</sup> C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the "Heineken effect"' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 174.

<sup>13</sup> There is no agreed definition of the term 'multinational enterprises'. The OECD Guidelines on Multinational Enterprises state that a clear definition was not required for the purpose of the guidelines, but then say the following about multinational enterprises: 'These usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, state or mixed.' See: OECD Guidelines for Multinational Enterprises (OECD 2000), Guideline I Concepts and Principles, para 3, available at: <http://www.oecd.org/dataoecd/56/36/1922428.pdf> (last accessed: 09/04/2013). Muchlinski opines that it may not be possible to define the term 'multinational corporation' with 'any degree of accuracy'. He states that an important feature of multinationals is their capacity to operate across national borders in terms of their business and managerial structure, their production and their trading. See: P Muchlinski, *Multinational Enterprises and the Law* (2nd ed, OUP 2007) 7 - 8.

<sup>14</sup> B Cragg, 'Home is where the halt is: Mandating Corporate Social Responsibility through home state regulation and social disclosure' (2010) 24 *Emory International Law Review* 735, 751.

<sup>15</sup> *ibid.*

consumer law is analysed in this thesis, as it might provide consumers with tools to enforce compliance of companies with their publicly adopted CSR commitments. Finally, as the violation of CSR principles can in some circumstances also constitute torts, for example negligence, tort law is included as the fourth private law area.

Even though CSR is a global issue, this thesis focuses on English law. The reason for this choice is that this work concentrates on private law which is closely embedded in national legal systems. Comparisons to other legal systems will be made occasionally, but it is beyond the scope of this thesis to substantially compare the way English private law engages with CSR with the private law of one or more other legal systems. The thesis thus aims to provide an overall picture of CSR in English private law, *inter alia*, by looking at English contract law, torts law, company law and consumer law. The results of this work can then be the basis for subsequent comparative analyses with other legal systems. Each of the substantive chapters will contain a brief overview of the jurisdictional scope, *i.e.* when English courts have jurisdiction to hear a dispute and when English law is applicable.

## **1.2 The aims of the thesis: The research agenda**

The primary research questions of this thesis are to what extent English private law already promotes CSR and to what extent English private law could better promote CSR. With these linked research questions, it is intended to show both the weaknesses and the strengths of private law in the promotion of CSR.

The word 'promote' is not a legal term.<sup>16</sup> It is used here to describe the role that English private law plays in the support, encouragement and further progression of CSR. In a legal context, the promotion of CSR could, *inter alia*, mean the following: Requiring, facilitating, enabling, incorporating and enforcing CSR. The aspect 'requiring' means that private law could, for example, through directors' duties or reporting duties, require directors to pursue CSR principles. Moreover, private law could also facilitate or enable the pursuing of CSR commitments, for instance, through discretion given to directors in directors' duties that they may pursue objects advancing the interest of all stakeholders of the company and not just the shareholders. Through contract law mechanisms, private law could enable companies to incorporate CSR commitments into their contracts with others. Finally, private law could provide tools to enforce CSR principles, for example, through the

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<sup>16</sup> 'To promote' is defined in the Oxford Dictionary of English, *inter alia*, as 'support', 'active encouragement' and 'further progression', see: <http://oxforddictionaries.com/> (last accessed: 20/10/2012).



enforcement of contractual CSR obligations, the enforcement of CSR commitments through consumer law or through liability in tort law. In short: The term 'promotion' is used here to denote that private law advances the socially responsible conduct of companies.

With its analysis of the promotion of CSR in English private law, this thesis aims to reveal the central position of private law in the regulatory framework of CSR. This position is, so far, not sufficiently reflected in the literature. The analysis of the four substantive areas of private law (company law and corporate governance, contract law, consumer law and tort law), brought together, will build on the existing literature which has so far only discussed the relationship between singular aspects of private law with CSR such as torts law or company law. On the basis of this approach, links will be drawn between the different areas of private law, for example, the influence of corporate theory on company law and corporate governance and the engagement of a company with CSR, for example, its voluntary incorporation of CSR policies into supply contracts. Overall, the analysis of the different areas of private law will show how English private law contributes or could make a better contribution to the promotion of CSR.

Moreover, the analysis of the primary research questions will also help to answer the secondary research question, which is to what extent English private law contributes to the implementation of the UN Guiding Principles on Business and Human Rights into English law. The UN Guiding Principles are intended to be implemented by countries and companies.<sup>17</sup> The UK government has made a political commitment to the Guiding Principles.<sup>18</sup> Due to the overlap between CSR and the Guiding Principles, the results of the four substantive chapters will also provide answers to the question to what extent English private law could be used by the UK government for the implementation of the Guiding Principles. However, it needs to be taken into account that the government will necessarily need to review

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<sup>17</sup> Office of the United Nations High Commissioner for Human Rights, 'New Guiding Principles on Business and Human Rights endorsed by the UN Human Rights Council', available at: <http://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=11164> (last accessed: 10/04/2013).

<sup>18</sup> UK Trade & Investment, 'Business and Human Rights': 'The Government is fully committed to implementing the Guiding Principles as part of its strategy on business and human rights and expects UK businesses to operate at all times in a way respectful of human rights whether in Britain or overseas.', see: [http://www.ukti.gov.uk/de\\_de/export/howwehelp/overseasbusinessrisk/item/print/308520.html?null](http://www.ukti.gov.uk/de_de/export/howwehelp/overseasbusinessrisk/item/print/308520.html?null) (last accessed: 16/02/2013). UK Trade & Investment is a UK government department that works in the area of international trade promotion. See also: Foreign Office Minister Jeremy Browne, 'A UK vision for business and human rights', Speech delivered on 6 July 2012, available at: <https://www.gov.uk/government/speeches/a-uk-vision-for-business-and-human-rights?view=Speech&id=784585582> (last accessed: 09/04/2013).

both public law and private law when it develops its national plan on the implementation of the Guiding Principles into English law.

### 1.3 Methodology

The thesis will be based on a doctrinal analysis of primary sources such as cases and statutes as well as secondary sources such as academic literature, Law Commission papers and the CSR reports of companies. Although the thesis is primarily doctrinal in nature, it will also engage with some of the socio-legal literature regarding regulation, such as that concerning meta-regulation.

Van Hoecke defines legal doctrine as a hermeneutical discipline because it focusses on the interpretation of texts and documents according to standard methods.<sup>19</sup> In his view 'the core business of legal doctrine is interpretation'.<sup>20</sup> Legal scholars often argue about a choice among diverging interpretations. For Birks a doctrinal legal approach 'criticises, explains, corrects and directs legal doctrines'.<sup>21</sup> It allows the answering of a concrete legal question.<sup>22</sup> Van Gestel and Micklitz identify shared features of doctrinal legal research in Europe and the U.S.: First, the basis for arguments is found in authoritative sources, such as existing rules, principles, precedents and scholarly publications. Secondly, legal doctrine tries to present the law as a system. Thirdly, decisions in cases have to fit into a coherent system.<sup>23</sup>

Van Hoecke summarises his analysis of legal doctrine as follows:

Legal scholars collect empirical data (statutes, cases, etc.), word hypotheses on their meaning and scope, which they test, using the classic canons of interpretation. In a next stage, they build theories...which they test and from which they derive new hypotheses... Described in this way, doctrinal legal scholarship fits perfectly with the methodology of other disciplines.<sup>24</sup>

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<sup>19</sup> M van Hoecke, 'Legal Doctrine: Which Method(s) for What Kind of Discipline?' in M van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 4.

<sup>20</sup> *ibid*, 3

<sup>21</sup> P Birks, 'Editor's Preface' in P Birks (ed), *What are Law Schools For?* (OUP 1996) ix.

<sup>22</sup> M van Hoecke, 'Legal Doctrine: Which Method(s) for What Kind of Discipline?' in M van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 4.

<sup>23</sup> R van Gestel and H-W. Micklitz, 'Revitalizing Doctrinal Legal Research in Europe: What About Methodology?' EUI Working Papers (LAW2011/05, Department of Law) 26 (last accessed: 20/05/2013).

<sup>24</sup> M van Hoecke, 'Legal Doctrine: Which Method(s) for What Kind of Discipline?' in M van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 11.

Moreover, the Council of Australian Law Deans notes that doctrinal research

...involves rigorous analysis and creative synthesis, the making of connections between seemingly disparate doctrinal strands, and the challenge of extracting general principles from an inchoate mass of primary materials.<sup>25</sup>

Whilst doctrinal researchers of the law tend to remain close to primary source materials (legislation and the leading cases) and are often hesitant 'to move far beyond these mainstream materials (for example, 'soft law' regulations such as that found in codes of practice)<sup>26</sup>, this is not invariably the case. Vranken notes that the limits of 'the system' that is analysed in doctrinal research are not necessarily clear.<sup>27</sup> Although doctrinal legal research is often relevant for legal practice and informs legal practitioners such as judges or solicitors, it is not identical to practical legal research, as it focusses on the understanding of the law and not just on its application.<sup>28</sup>

The doctrinal method was chosen for this thesis as it is suitable to answer the underlying research questions, i.e. to what extent does English private law already promote or could better promote Corporate Social Responsibility?<sup>29</sup> The thesis focusses on the use of private law as a means to promote CSR. Based on the doctrinal method, the four substantive areas of law addressed in the thesis, for example company law and corporate governance, can, inter alia, be analysed as to their overlap with CSR, their use as a means to incorporate CSR into legal relationships as well as their use as a means to enforce the socially responsible conduct of companies. With the interpretation of texts and documents, the doctrinal approach is suitable for the pertaining questions of the thesis, i.e. 'what is the law in these areas?' as well as 'what changes are needed to that law in order to better promote CSR?' It helps not only to find out what the law is, but also what rights parties procure for violations of CSR. Moreover, as the doctrinal method interprets, criticises and synthesises legal doctrines, it enables the research to look at private law

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<sup>25</sup> Council of Australian Law Deans, Statement on the nature of legal research, taken from the CALD submissions to the Department of Education, Science and Training (DEST) in relation to the Research Quality Framework (RQF), May and October 2005.

<sup>26</sup> R Brownsword, 'An Introduction to Legal Research' (2006) 4, available at: [www.welcome.ac.uk/stellent/groups/corporatesite](http://www.welcome.ac.uk/stellent/groups/corporatesite) (last accessed: 22/09/2012).

<sup>27</sup> Vranken asks if those researchers that include codes of conduct, guidelines and other forms of self-regulation into their analysis would step outside the field defined for legal doctrinal scholars when they argue that these factors should be included, see J Vranken, 'Methodology of Legal Doctrinal Research: A Comment on Westerman' in M van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 116.

<sup>28</sup> M Siems and D Síthigh, 'Mapping Legal Research' (2012) 71 *CLJ* 651, 654.

<sup>29</sup> As noted above, 'to promote' is not a legal term, it rather encapsulates, inter alia, the following: Requiring and enabling socially responsible conduct of companies, incorporating CSR and enforcing CSR.

as a whole in terms of its promotion of CSR and to make connections between these areas.

#### **1.4 The scope of the thesis**

As already noted, the thesis will be based on the analysis of four substantive areas of private law. These are: Company law and corporate governance, contract law, consumer law and tort law.

First, the chapter on 'Company law, corporate governance and CSR' will provide a detailed analysis of how company law and corporate governance promote CSR. The chapter will start with an examination of how corporate theory (shareholder value vs. stakeholder value) influences the ways in which companies address CSR. Discussions about corporate theory are relevant for CSR, as the underlying theory of the firm influences the scope and aims of company law and corporate governance and, consequently, the ways in which companies are required or allowed to pursue CSR objectives. The chapter then analyses the extent to which the new directors' duty in s172 (1) Companies Act (duty to promote the success of the company for the benefit of its members as a whole) and the reporting duty in s417 (2) Companies Act assist in the promotion of CSR. The chapter also addresses the role of shareholders in enhancing the socially responsible conduct of companies, for example through the derivative action (brought for a breach of s172 CA). The final part of this chapter focusses on the composition of the board and its possible impact on the pursuing of CSR.

Secondly, the chapter on contract law will provide a detailed analysis of the promotion of CSR through supply chain contracts. The reason for the focus on supply chain contracts is that Western companies commonly incorporate CSR policies into their supply chain relations with their suppliers.<sup>30</sup> The way this incorporation is usually done is by adopting a code of conduct which outlines the company's CSR policy and the principles it expects everyone within the company to uphold. Many companies expect their suppliers to adhere to these principles, too, and consequently incorporate these codes of conduct into their supply chain contracts with their suppliers. Whilst the incorporation of CSR into supply chains has been extensively analysed in the management literature, there has only been little

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<sup>30</sup> E Pedersen and M Andersen, 'Safeguarding corporate social responsibility (CSR) in global supply chains: how codes of conduct are managed in buyer-supplier relationships' (2006) 6 *Journal of Public Affairs* 228, 237; B Jiang, 'Implementing Supplier Codes of Conduct in Global Supply Chains: Process Explanations from Theoretic and Empirical Perspectives' (2009) 85 *Journal of Business Ethics* 77, 77-78.

writing from a legal perspective so far.<sup>31</sup> This chapter seeks to contribute to the legal CSR literature by providing a detailed analysis of the contract law rules pertaining to the incorporation of CSR into supply contracts. The chapter will analyse whether CSR policies become ‘part’ of the supply contracts and hence become enforceable (either by the Western company at the head of the supply chain or by, for example, an employee of the supplier). Secondly, the chapter analyses whether the Western companies are able to procure an appropriate remedy in contract law for these breaches. Thirdly, the Western companies (the buyers) must be sufficiently aware of breaches of these contractual terms pertaining to the CSR policies in order to at least consider using contract law to promote socially responsible behaviour among those companies in transitional economies where concerns about violation of CSR issues such as human rights are focused.

The third chapter will analyse the extent to which English consumer law promotes or could better promote CSR. Consumer law is chosen as one of the four substantive areas of private law in this thesis as many companies make their CSR commitments public whilst consumers increasingly consider corporate responsibility in their purchase and consumption behaviour (described by the term ‘ethical consumerism’).<sup>32</sup> Consumer law and CSR overlap where consumers are protected against false information about the CSR practices of companies. The chapter will analyse whether consumer law protects consumers in the situation where companies are in breach of their publicly announced CSR commitments, for example, if a company violates the principles of a code of conduct to which it has signed up and which it has published on its website. To that end, the chapter will analyse whether breaches of CSR policies by companies are encompassed by English consumer law at all (looking at the Consumer Protection from Unfair Trading Regulations 2008 and the law of misrepresentation) and, if this is the case, then examine whether consumers procure an appropriate remedy in such a situation. Secondly, the chapter will address the question of how consumer law could better promote CSR. This section will particularly discuss the recent recommendations of the Law Commission about the introduction of consumer redress for misleading and aggressive practices which were published in March 2012.

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<sup>31</sup> See for example for the management literature: J Leigh and S Waddock, ‘The Emergence of Total Responsibility Management Systems: J. Sainsbury’s (plc) Voluntary Responsibility Management Systems for Global Food Retail Supply Chains (2006) 111 (4) *Business and Society Review* 409.

<sup>32</sup> See N C Smith, ‘Consumers As Drivers Of Corporate Social Responsibility’ in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 281; M Carrington, B Neville and G Whitwell, ‘Why Ethical Consumers Don’t Walk Their Talk: Towards a Framework for Understanding the Gap Between the Ethical Purchase Intentions and Actual Buying Behaviour of Ethically Minded Consumers’ (2010) 97 *Journal of Business Ethics* 139.

The fourth substantive chapter will analyse the extent to which English tort law promotes the socially responsible behaviour of companies. CSR and the law of torts overlap where tort law protects the interests that CSR requires companies to pursue, such as the adherence to human rights or the protection of the environment. The violation of CSR principles can therefore in some circumstances constitute torts, for example negligence. Based on a case study of corporate conduct that violates CSR principles, the analysis of the promotion of CSR in English tort law will consider if and, if so, how the different causes of action in English tort law encompass violations of CSR principles. The chapter will also analyse whether the tort victims procure an appropriate remedy against the tortfeasor. It will then address challenges of using tort law as an instrument for the promotion of CSR, for example, the existence of corporate group structures consisting of a parent company and several subsidiaries.

The remainder of the thesis draws the threads of the analysis together. The final chapter will first discuss the limitations of private law in the promotion of CSR and then the contribution that private law makes to the promotion of CSR. The limitations are discussed under three headings: First, the continuing dominance of the shareholder value theory; secondly, the patchy coverage of private law; and thirdly the weaknesses of private law remedies. The contributions that CSR makes to the promotion of CSR are addressed subsequently under the following titles: First, the overlap between CSR and private law (leading to the argument that CSR is, at least in part, law); secondly, the mechanisms that private law provides for the incorporation and enforcement of CSR; thirdly, the contribution of private law to hybrid regulatory systems of CSR. The chapter will then discuss limitations of this research and the scope for subsequent research on CSR and the law, following the conclusion of this thesis. Finally, the chapter will provide a list of substantive recommendations for changes to English law that result from the analysis. Within the discussion of the limitations and the strengths of private law in the promotion of CSR, this chapter will also address the question to what extent English private law could contribute to the implementation of the UN Guiding Principles on Business and Human Rights into English law.

## Chapter 2: The regulatory framework of CSR; Literature review

### 2.1 Introduction

The aim of this chapter is threefold. First of all, it will set up core material for the thesis. It will summarise the debate surrounding how CSR is defined and briefly introduce the various normative justifications that are used for CSR. Secondly, this chapter will provide an overview of the regulatory framework of CSR by looking at the following levels: International law, European Union law, domestic legislation in English law and private regulation. The purpose of this analysis is to demonstrate the significance of private law for CSR in its broader contexts. Thirdly, the chapter will critically review the existing literature on CSR and the law in light of the regulatory framework. The particular focus of the analysis is the question if and, if so, how the existing literature comprehends (or has failed to comprehend) the roles of private law in this regulatory framework.

### 2.2 Key terminology

#### 2.2.1 The debate about the definition of CSR

Although the term Corporate Social Responsibility is widely used, it is far from clear how it is defined.<sup>33</sup> In fact, there is no generally accepted definition of CSR and the growing academic and public interest in the concept of CSR has only added to the number of existing definitions.<sup>34</sup> It is often said that the debate about the definition of CSR is exacerbated by the interests of the different groups involved with CSR.<sup>35</sup> Horrigan observes that CSR has 'many different definitions, grounded in many different standpoints from which it can be approached'.<sup>36</sup> Nevertheless, a clear definition of CSR and related concepts would be useful in order 'to avoid talking at

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<sup>33</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 34. It is important to note that some authors refer to 'corporate responsibility' only thus omitting the word 'social'. This is frequently done without explanation, for example by Horrigan in his book *Corporate Social Responsibility in the 21<sup>st</sup> century* (Edward Elgar 2010). Nevertheless, the concept is in this book, as in many other publications, still labelled CSR. Insofar as this thesis engages with or refers to literature which uses 'corporate responsibility', it will be examined in the same way as literature that refers to Corporate Social Responsibility, as the majority of authors still seem to have the same concept in mind. Moreover, Corporate Social Responsibility is the most widely used term. See for a discussion about the use of the term Corporate Responsibility: J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 32.

<sup>34</sup> See for a discussion about definitions of CSR: C Villiers, 'Corporate law, corporate power and corporate social responsibility' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 91-93.

<sup>35</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 29.

<sup>36</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 34.

cross-purposes'.<sup>37</sup> The following part will therefore seek to define CSR for the purpose of this thesis.

The Confederation of Business Industry (CBI) defines CSR as 'the acknowledgement by companies that they should be accountable not only for their financial performance, but also for the impact of their activities on society and/or the environment.'<sup>38</sup> Notably, the CBI definition adds that CSR is 'voluntary', 'business-driven' and often goes 'well beyond' what is required by legislation. The UK government approaches CSR in a similar way: 'Corporate Responsibility can be defined as how companies address the social, environmental and economic impacts of their operations and so help to meet our sustainable development goals.'<sup>39</sup> It would specifically encompass 'the voluntary actions that business can take, over and above compliance with minimum legal requirements'.

The long-standing definition of the European Commission used until its 2011 communication on CSR corresponded with this approach, as it defines CSR as 'a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis'.<sup>40</sup>

All three of these definitions have in common that they define CSR as a voluntary undertaking. There thus appears to be a distinction between CSR and the law. CSR is characterised as corporate actions above and beyond legal obligations. The effect of these definitions is that law and CSR are separate concepts. In terms of the content of CSR, these definitions focus on the social and environmental impact of corporations.

However, the view that CSR is, by definition, a voluntary matter is far from settled. Doubts have been raised whether or not CSR can still be considered to be purely voluntary, arguing that research has shown that CSR produces a variety of legal

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<sup>37</sup> N Boeger, R Murray and C Villiers 'Introduction' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 1.

<sup>38</sup> Confederation of British Industry (CBI), 'Issue Statement: Corporate Social responsibility' (2001), available at:

<http://www.cbi.org.uk/ndbs/content.nsf/802737AED3E3420580256706005390AE/9D502144AC9F644380256F58005BD16C> (last accessed: 03/10/2012).

<sup>39</sup> Department for Business, Innovation and Skills, 'Corporate Responsibility', available at: <http://www.bis.gov.uk/policies/business-sectors/low-carbon-business-opportunities/sustainable-development/corporate-responsibility> (last accessed: 20/02/2012).

<sup>40</sup> European Commission, 'Green paper: Promoting a European framework for Corporate Social Responsibility', COM (2001) 366 final, 20.



effects.<sup>41</sup> There are several broader definitions in the academic literature which are more open to the question whether or not CSR is purely a voluntary commitment, for example the definition provided by Sheikh who defines CSR as ‘the assumption of responsibilities by companies, whether voluntarily or by virtue of statute, in discharging socioeconomic obligations in society’.<sup>42</sup> Other scholars have followed this approach. For example, Zerk applies a broader approach to CSR. In her view, CSR refers to the notion that ‘each business enterprise, as a member of society has a responsibility to operate ethically and in accordance with its legal obligations and to strive to minimise any adverse effects of its operations and activities on the environment, society and human health’.<sup>43</sup> She concludes that the reason for the controversies about how to define CSR might be that these definitions are often presented ‘with an agenda in mind’. Hereby Zerk indicates that business organisations and NGOs often argue for either a voluntary or mandatory understanding of CSR in order to promote their political agenda in this respect.

Acknowledging that no clear consensus has yet been reached about what exactly CSR means, Campbell and Vick define CSR in the following way:

At a minimum the term implies an obligation on the part of large companies to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders but also employees, consumers, suppliers, creditors and local communities. These interests are not just economic, but also include environmental, human rights and ‘quality of life’ concerns. The obligation to be socially responsible is usually conceived of as being over and above the minimum requirement imposed on companies by formal legal rules, although this is not invariably the case.<sup>44</sup>

It is an important aspect of this definition that, whilst it acknowledges that CSR is often perceived of as being voluntary, it also includes statutory CSR obligations. The strength of this approach is that it recognises that, for example, mandatory legislation sometimes addresses issues which are part of the CSR agenda, such as bribery and corruption offences. Campbell and Vick refer to the Anti-Terrorism, Crime and Security Act 2001 which, at the time the chapter from these authors was published, stipulated that UK companies and company directors could be prosecuted for bribery and corruption offences wherever they are committed in the world (ss. 108 – 110). Since then, these provisions (along with other previous statutory and common law provisions on bribery) have been repealed by the Bribery

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<sup>41</sup> C Glinski, ‘Corporate codes of conduct: moral or legal obligation’ in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 147.

<sup>42</sup> S Sheikh, *Corporate Social Responsibilities: Law and Practice* (Cavendish 1995) 15.

<sup>43</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 32.

<sup>44</sup> K Campbell and D Vick, ‘Disclosure Law and the market for corporate social responsibility’ in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 242.

Act 2010.<sup>45</sup> The Bribery Act replaced these provisions, inter alia, with the crimes of bribery and the failure of a commercial organisation to prevent bribery on its behalf.<sup>46</sup>

The core of these different definitions is a shared belief that companies have a responsibility for the public good.<sup>47</sup> There is, by and large, a consensus about the aims of CSR – to make corporations advance the interests of those who are affected by their activities, focusing in particular on the social and environmental impact of their work. However, as already noted, the definitions are less unanimous about the question whether CSR does or should achieve these aims by means of legal and/or voluntary concepts.<sup>48</sup>

This thesis will adopt the definition from Campbell and Vick which does not exclude mandatory CSR regulation.<sup>49</sup> This definition has several advantages. Firstly, it enumerates various groups (stakeholders) affected by a corporation. Secondly, it explicitly includes economic, environmental and human rights issues into the ambit of CSR, thus clarifying that these are specific issues that are encompassed by CSR in any case. The reference to ‘quality of life concerns’ allows for flexibility as to the exact scope of CSR. Thirdly, it is an advantage of this definition that, whilst it acknowledges that CSR is traditionally often perceived of as being voluntary, it also states that it can be mandatory. This approach reflects the situation that there are statutory legal requirements which overlap with CSR, for example, the duty to promote the success of the company pursuant to s172 (1) Companies Act 2006.<sup>50</sup> This definition thus supports one of the core arguments of this thesis, namely that CSR is, at least in part, law. Notably, the position that CSR is purely voluntary seems to be losing ground, as evidenced, inter alia, by the fact that, in its 2011 communication on CSR, the European Commission puts forward a new definition of CSR that no longer classifies CSR as ‘voluntary’. According to the Commission’s new definition CSR is ‘the responsibility of enterprises for their impacts on society’.<sup>51</sup>

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<sup>45</sup> Schedule 2 of the Bribery Act 2010 replaces ss108 – 110 of the Anti-Terrorism, Crime and Security Act 2001.

<sup>46</sup> ss1, 7 Bribery Act 2010.

<sup>47</sup> M Blowfield and A Murray, *Corporate responsibility: A critical introduction* (OUP 2008) 13.

<sup>48</sup> These findings are confirmed by a study which is based on the analyses of 37 different definitions of CSR. See: A Dahlsrud, ‘How Corporate Social Responsibility is Defined: an Analysis of 37 Definitions’ (2008) 15 *Corporate Social Responsibility and Environmental Management* 1.

<sup>49</sup> See K Campbell and D Vick, ‘Disclosure Law and the market for corporate social responsibility’ in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 242.

<sup>50</sup> s417 CA 2006: ‘Contents of directors’ report: business review’.

<sup>51</sup> European Commission, ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A renewed EU strategy 2011-14 for Corporate Social Responsibility’ COM (2011) 681 final, para 3.1.

## 2.2.2 Theories of CSR

Closely related with the debate about the definition of CSR is the question why companies engage or should engage with CSR. It is beyond the scope of this thesis, however, to discuss the different normative justifications for CSR in detail. Garriga and Melé classify the main CSR theories into four groups.<sup>52</sup> They call the first group instrumental theories, as these theories assume that the corporation is purely an instrument for wealth creation.<sup>53</sup> This view is evident in the famous statement from Milton Friedman that ‘there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game’.<sup>54</sup> This theory of CSR is in accordance with the shareholder value theory of the firm.<sup>55</sup> Companies may engage with CSR only in order to promote business. This approach has become known as the ‘business case’ for CSR.<sup>56</sup> Consequently, social activities are only accepted if they increase the wealth of the company. The second group (called political theories) emphasises the social power of companies. According to this theory, companies must accept social duties due to the power that they wield.<sup>57</sup> The corporate citizenship concept, which belongs to this group, focusses on the business responsibility towards the local community where it operates.<sup>58</sup> The third group, the integrative theories, argues that firms should integrate social issues as they depend on society.<sup>59</sup> And, finally, the fourth group focusses on the ethical values underlying the relationships between business and society. The stakeholder theory belongs to this group of theories, known as ethical theories. This theory argues that companies must

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<sup>52</sup> E Garriga and D Melé, ‘Corporate Social Responsibility Theories: Mapping the Territory’ (2004) 53 *Journal of Business Ethics* 51, 52. Millon distinguishes between two different theories of CSR which he calls ‘the ethical model of CSR’ and ‘the strategic model of CSR’. The ethical model (also called ‘the constituency model of CSR’ in an earlier article by Millon) is based on the argument that the management of the company should balance the interests of shareholders and non-shareholders. It rejects the idea of maximising shareholder value. This model generally assumes that the interests of shareholders and non-shareholders conflict. The other model, the strategic model (called ‘the sustainability model of CSR’ in an earlier article by Millon), argues that CSR is undertaken by companies in order to promote the profits and shareholder wealth. The long-term prosperity of the company depends on the well-being of the company’s various stakeholders. This approach is based on the ‘business case’ for CSR. See: D Millon, ‘Shareholder Social Responsibility’ (2013) 36 *Seattle University Law Review* 912, 922 – 928; D Millon, ‘Two Models Of Corporate Social Responsibility’ (2011) 46 *Wake Forest Law Review* 523.

<sup>53</sup> *ibid.*

<sup>54</sup> M Friedman, ‘The Social Responsibility of Business is to Increase its Profits’ *The New York Times Magazine* (New York, 13 September 1970).

<sup>55</sup> This theory will be discussed in detail in the chapter on ‘Company law, Corporate governance and CSR’ in this thesis.

<sup>56</sup> E Kurucz, B Colbert and D Wheeler, ‘The Business Case for Corporate Social Responsibility’ in A Crane and others (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 84.

<sup>57</sup> E Garriga and D Melé, ‘Corporate Social Responsibility Theories: Mapping the Territory’ (2004) 53 *Journal of Business Ethics* 51, 55.

<sup>58</sup> D Melé, ‘Corporate Social Responsibility Theories’ in A Crane and others (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 68.

<sup>59</sup> E Garriga and D Melé, ‘Corporate Social Responsibility Theories: Mapping the Territory’ (2004) 53 *Journal of Business Ethics* 51, 57.

balance the interests of all stakeholders of the firm rather than purely pursue the interests of the company's stockholders.<sup>60</sup> The stakeholder theory will be discussed in detail in the chapter on 'Company law, corporate governance and Corporate Social Responsibility'.

### 2.2.3 Private law

Whilst there is an ongoing debate about the question whether or not a public/private divide is justifiable in English law, it is necessary to, at least, adopt a working definition of private law in this thesis, due to the focus of the analysis.<sup>61</sup> Oliver notices that more attention is paid to defining public law than to defining private law.<sup>62</sup> The general assumption seems to be that private law is a residual area, i.e. the area of the law that is not public law. Hedley, too, admits that private law is, though much used by lawyers, only rarely defined in common law systems.<sup>63</sup> According to a common definition, public law is concerned with relations between the individual and the state as well as the distribution of power between public institutions and a range of non-governmental organisations.<sup>64</sup> Loughlin defines public law as 'simply a sophisticated form of political discourse; controversies within the subject are simply extended political disputes'.<sup>65</sup>

Lord Woolf identifies the function which is performed as the essential criterion for distinguishing between public law and private law. If the function is a governmental activity, then it is public law.<sup>66</sup> He defines private law as the system which protects the private rights of private individuals or the private rights of public bodies. Cane follows a similar approach, but simply calls the activity 'private activity' and 'public activity'. The classification of an area of law into either public law or private law depends on a value judgment about whether the performance ought to be controlled by public or private law principles.<sup>67</sup> Hedley notes that private law would often be described as 'the law between private individuals that is contrasted with the law involving organs of the state which is public law'.<sup>68</sup> Hedley's definition mirrors the one suggested by Lord Woolf which looks at the function performed as the distinguishing factor between private law and public law. This thesis will adopt the

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<sup>60</sup> *ibid*, 60.

<sup>61</sup> See for the discussion about the public/private divide in English law: D Oliver, *Common Values and the Public-Private Divide* (Butterworths 1999) 9; Lord Woolf, 'Droit public – English style' [1995] *PL* 57, 61.

<sup>62</sup> D Oliver *Common Values and the Public-Private Divide* (Butterworths 1999) 15.

<sup>63</sup> S Hedley, 'Is private law meaningless?' (2011) 64 *Current Legal Problems* 89.

<sup>64</sup> D Oliver, *Common Values and the Public-Private Divide* (Butterworths 1999) 14.

<sup>65</sup> M Loughlin, *Public Law and Political Theory* (Clarendon Press 1992) 4.

<sup>66</sup> Lord Woolf, 'Droit public – English style' [1995] *PL* 57, 62.

<sup>67</sup> P Cane, *Administrative Law* (OUP 2011) 18.

<sup>68</sup> S Hedley, 'Is private law meaningless?' (2011) 64 *Current Legal Problems* 89.

definition used by Lord Woolf as it clearly identifies private law with its reference to the rules which regulate private rights between private individuals. This definition encompasses those areas of law that are traditionally understood as private law, i.e. contract law, tort law and property law, but it also allows for expanding the scope of private law to cover areas such as company law, consumer law and commercial law. This definition accords with Oliver's classification of several areas of law as private law, namely tort, contract law, company law and restraint of trade.<sup>69</sup> On the basis of this definition, the areas of law analysed in the substantive chapters of this thesis are all private law (i.e. Company law and corporate governance, Contract law, Consumer law, Tort law).

### **2.3 The regulatory framework of CSR**

This thesis adopts a broad understanding of regulation as 'all mechanisms of social control or influence affecting behaviour from whatever source, whether intentional or not'.<sup>70</sup> This definition potentially encompasses different forms of regulation including the traditional state-based regulation. This approach is in line with those who see regulation as a concept that includes law, but is not limited to law.<sup>71</sup> This definition therefore conceives of regulation as 'a broader social phenomenon than law'.<sup>72</sup> Regulation need not originate from the state. It also encompasses other means of exercising social control or influence to affect behaviour, including 'unintentional and non-state processes'.<sup>73</sup> The term 'regulation' can therefore be used to refer to a range of regulatory forms, including governmental and non-governmental, national, transnational and global ones. This broad understanding of regulation is important as CSR is particularly based on private regulation, for example codes of conduct developed by corporations themselves or third parties such as non-governmental organisations.

#### **2.3.1 International law level**

The CSR instruments of international governing bodies, such as the UN, are predominately soft law recommendations and guidelines.<sup>74</sup> In the international law context, 'soft law' is used to denote 'principles and policies which have been

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<sup>69</sup> D Oliver *Common Values and the Public-Private Divide* (Butterworths 1999) 15.

<sup>70</sup> J Black, 'Decentering regulation: Understanding the role of regulation and self-regulation in a post-regulatory world' (2001) 54 *Current Legal Problems* 103, 129.

<sup>71</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 59.

<sup>72</sup> J Black, 'Law and regulation: The case of finance' in C Parker, C Scott, N Lacey and J Braithwaite (eds), *Regulating Law* (OUP 2004) 33.

<sup>73</sup> R Baldwin and M Cave, *Understanding Regulation: Theory, Strategy and Practice* (OUP 1999) 2.

<sup>74</sup> B Cragg, 'Home is where the halt is: Mandating Corporate Social Responsibility through home state regulation and social disclosure' (2010) 24 *Emory International Law Review* 735, 744.

negotiated and agreed between states, or promulgated by international institutions, but which are not mandated by law or subject to any formal enforcement mechanisms'.<sup>75</sup> Influential soft law public international law instruments on CSR are said to be the OECD (Organisation for Economic Co-operation and Development) Guidelines for Multinational Enterprises<sup>76</sup>, the 1977 ILO (International Labour Organization) Tripartite Declaration Concerning Multinational Enterprises and Social Policy (the ILO Tripartite Declaration)<sup>77</sup> and the UN Global Compact.<sup>78</sup>

### 2.3.1.1 United Nations

An early CSR initiative was the Draft UN Code of Conduct on Transnational Corporations (the 'Draft UN Code').<sup>79</sup> The UN attempted to address the challenges posed by multinational companies with the establishment of the United Nations Commission on Transnational Corporations (UNCTC), an intergovernmental forum for deliberations on multinational corporations.<sup>80</sup> The UNCTC worked on the formulation of a code of conduct for multinational corporations.<sup>81</sup> The UN adopted a draft code in 1983, and revised versions of it in 1988 and 1990.<sup>82</sup> The final version of the draft code addresses a range of general political, social, economic and development issues, including human rights.<sup>83</sup> Transnational corporations are required 'to respect human rights and fundamental freedoms in the countries in which they operate...'<sup>84</sup> The Code also contains guidelines regarding the protection of consumers<sup>85</sup> and the environment.<sup>86</sup> The UNCTC was closed in 1993 which

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<sup>75</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 70; For a general introduction see D L Shelton, 'Soft Law' in D Armstrong (ed), *Routledge Handbook of International Law* (Routledge 2009) 68.

<sup>76</sup> The OECD Guidelines for Multinational Enterprise were most recently updated in 2011. The text of the revised version of the OECD Guidelines for Multinational Enterprises is available at [http://www.oecd.org/document/28/0,3746,en\\_2649\\_34889\\_2397532\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html) (last accessed 09/04/2013).

<sup>77</sup> ILO Tripartite Declaration, (1978) 17 ILM 422, last amended 2006, [http://www.ilo.org/empent/Publications/WCMS\\_094386/lang--en/index.htm](http://www.ilo.org/empent/Publications/WCMS_094386/lang--en/index.htm) (last accessed: 09/04/2013).

<sup>78</sup> I Bantekas, 'Corporate Social Responsibility in International Law' (2004) 22 *Boston University International Law Journal* 309, 317.

<sup>79</sup> UN, Draft UN Code of Conduct on Transnational Corporations, UN Doc. E/1990/94, 12 June 1990.

<sup>80</sup> O Amao, 'The foundation for a global company law for multinational corporations' (2010) 21 *ICCLR* 275, 280.

<sup>81</sup> F Nattier, 'Regulation of Transnational Corporations: Latin American Actions in International Fora' (1984) 19 *Texas International Law Journal* 265, 280.

<sup>82</sup> See UN, Draft UN Code of Conduct on Transnational Corporations, UN Centre on Transnational Corporations, Special Session (March 7-18, 1983 and May 9-20, 1983): UN Doc.E/C.10/1982/6 (1986); Code of Conduct on Transnational Corporations, UN ESCOR, Organisational Session for 1988, Provisional Agenda Item 2, at p.4, UN Doc. E/1988 (39(Add.1) (1988); Development and International Economic Cooperation: Transnational Corporations, UN ESCOR, 2d See, Agenda Item 7(d), para.13, UN Doc E/1990/94 (1990).

<sup>83</sup> UN, Draft UN Code of Conduct on Transnational Corporations, UN Doc. E/1990/94, 12 June 1990.

<sup>84</sup> *ibid*, para 14.

<sup>85</sup> *ibid*, para 37.

<sup>86</sup> *ibid*, para 41.

brought the work on the Draft Code to an end.<sup>87</sup> The Draft Code was never adopted. Its legal status was never finally settled, but by 1990 the UNCTC had accepted the likelihood that the code would remain voluntary.<sup>88</sup> Even though the code was never adopted, it has been argued that it is of historical significance as a document that demonstrates international consensus on the responsibilities of multinationals as early as during the 1980s.<sup>89</sup>

An important UN source of CSR is the UN Global Compact which was launched in September 2000 by the UN Secretary-General Kofi Annan. He asked business leaders to voluntarily 'embrace and enact' principles of the Compact. The UN Global Compact was not created by states through a negotiated international treaty, but it was initiated by the UN General Secretary together with business actors and UN agencies. Members of the UN Global Compact are corporations, employers' and employee' organisations, state institutions and civil society organisations.<sup>90</sup> Since its launch it has grown to more than 8,000 participants, including over 5,300 businesses in 130 countries around the world.<sup>91</sup> It was the underlying aim to provide for simple means of becoming a member of the Global Compact.<sup>92</sup> The Global Compact contains ten principles on human rights, labour standards, environmental protection and about fighting corruption. The Global Compact was not intended to be a 'regulatory instrument'.<sup>93</sup> It is not a code of conduct.<sup>94</sup> Still, corporations who have subscribed to it are required to submit examples of how they have complied with the Principles on an annual basis.<sup>95</sup> The Global Compact has been subject to criticisms due to the lack of sanctions against corporations who do not comply with the principles. It has been argued that corporations only agreed to the Global Compact 'after it had been degraded to a toothless instrument'.<sup>96</sup> These criticisms eventually led to a control mechanism that enables the Global Compact to exclude

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<sup>87</sup> D Abrahams, *Regulations for Corporations: A historical account of TNC regulation* (UNRISD 2005).

<sup>88</sup> UNCTC, *Transnational Corporations, Services and the Uruguay Round*, UNC Doc. ST/CTC/103 (New York: UN, 1990), 175.

<sup>89</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 248.

<sup>90</sup> See UN Global Compact, *Global Compact Participants*, available at: <http://www.unglobalcompact.org/ParticipantsandStakeholders/index.html> (last accessed 09/04/2013).

<sup>91</sup> *ibid* (last accessed 09/04/2013).

<sup>92</sup> W Kaleck and M Saage-Maass, 'Corporate accountability for human rights violations amounting to international crimes: the status quo and its challenges' (2010) *Journal of International Criminal Justice* 699, 714.

<sup>93</sup> See UN Global Compact, <http://www.unglobalcompact.org/AboutTheGC/index.html> (last accessed 09/04/2013).

<sup>94</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 259.

<sup>95</sup> See UN Global Compact, <http://www.unglobalcompact.org/AboutTheGC/integrity.html> (last accessed 09/04/2013).

<sup>96</sup> N Weiß, 'Transnationale Unternehmen – weltweite Standards? Eine Zwischenbilanz des Global Compact' (2002) 2 *MenschenRechtsMagazin* 82, 88.

members who severely violate the principles.<sup>97</sup> And, in fact, the UN reports in 2009 that it has delisted more than 1,000 members for failure to meet the UN Global Compact's mandatory annual reporting requirement, also known as the Communication on Progress (COP) policy.<sup>98</sup>

The UN Sub-Commission for the Promotion and Protection of Human Rights published in 2003 the 'Norms on the Responsibility of Transnational Corporations and Other Business Enterprises with regard to human rights obligations'.<sup>99</sup> The underlying idea was that the Norms should be adopted by the member states. However, as the Norms tried to impose legally binding obligations on transnational companies, they were viewed rather critically by several member states and rejected.<sup>100</sup> NGOs, on the other hand, welcomed them.<sup>101</sup> The difference between the Norms and previous CSR initiatives is that they sought to extend the reach of international law to transnational corporations by directly imposing obligations upon them.<sup>102</sup> It was essentially the aim of the Norms to impose on companies the same human rights duties as states have accepted under treaties.<sup>103</sup> Due to the controversy about the Norms, the UN Commission on Human Rights finally failed to adopt the document.<sup>104</sup>

The UN Secretary-General subsequently appointed Professor John Ruggie of Harvard University as Special Representative on the issue of human rights and business (SRSG).<sup>105</sup> During his six-year mandate, Ruggie engaged in an extensive

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<sup>97</sup> UN Global Compact, Integrity Measures, No. 4, available at: <http://www.unglobalcompact.org/AboutTheGC/IntegrityMeasures/index.html> (last accessed 09/04/2013).

<sup>98</sup> United Nations, '1,000 Companies Delisted by UN Global Compact Since 2008' (New York, 7 October 2009), available at: [http://www.unglobalcompact.org/NewsAndEvents/news\\_archives/2009\\_10\\_07.html](http://www.unglobalcompact.org/NewsAndEvents/news_archives/2009_10_07.html) (last accessed 09/04/2013).

<sup>99</sup> UN Doc. E/CN4/Sub.2/2003/12/Rev.2 of 26 August 2003.

<sup>100</sup> See generally about the debate D Kinley, J Nolan and N Zerial, 'The Norms are Dead! Long live the Norms! The politics behind the UN Human Rights Norms for corporations' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 459.

<sup>101</sup> *ibid.*

<sup>102</sup> B Cragg, 'Home is where the halt is: Mandating Corporate Social Responsibility through home state regulation and social disclosure' (2010) 24 *Emory International Law Review* 735, 746.

<sup>103</sup> J Ruggie, 'The construction of the UN "protect, respect and remedy" framework for business and human rights: the true confessions of a principled pragmatist' (2011) *EHRLR* 127.

<sup>104</sup> O Amao, 'The foundation for a global company law for multinational corporations' (2010) *ICCLR* 275, 281.

<sup>105</sup> UN Secretary-General, 'Secretary-General Appoints John Ruggie of United States Special Representative on Issue of Human Rights, Transnational Corporations, Other Business Enterprises', 28 July 2005, UN Doc SGA/A/934, available at: <http://www.un.org/News/Press/docs/2005/sga934.doc.htm> (last accessed 09/04/2013). The website of the Special Representative of the Secretary-General on human rights and transnational corporations and other business enterprises gives a useful overview about the work done within the mandate, see: <http://www.business-humanrights.org/Home> and also: <http://www.ohchr.org/EN/Issues/Business/Pages/SRSGTransCorpIndex.aspx> (last accessed: 09/04/2013). John Ruggie was appointed by the UN Secretary-General of that time, Kofi Annan, to



consultation process and reported six times.<sup>106</sup> Ruggie criticised the Norms for 'intermingling the respective roles of states and business'.<sup>107</sup> In his 2008 report, Ruggie proposed a three-pillar framework for corporate accountability for human rights, which he describes as 'Protect, Respect and Remedy'. The framework 'rests on differentiated but complementary responsibilities'.<sup>108</sup> Ruggie's work during his mandate led to the Guiding Principles on Business and Human Rights which were published in 2011.<sup>109</sup> The Guiding Principles were endorsed by the United Nations Human Rights Council in June 2011.<sup>110</sup> Human rights are an important element of the CSR agenda.<sup>111</sup> The Guiding Principles have therefore been called 'a landmark in the CSR debate'.<sup>112</sup> The UN Guiding Principles are organised in three pillars: the state duty to protect human rights, the corporate duty to respect human rights, and the need for access to effective remedy mechanisms when abuses occur. The Guiding Principles distinguish between the duties of states and the responsibilities of companies in order to indicate that respecting rights is not an obligation that current international human rights law generally imposes directly upon companies.<sup>113</sup> The

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review the impact of business on human rights, following the failure of the so-called Norms on Transnational Corporations and Other Business Enterprises. The Norms were drafted by an expert subsidiary body of the then Commission on Human Rights. They sought to impose direct human rights duties on companies in international law to the same extent as states had ratified for themselves under treaties. However, the Commission declared in 2004 that it had not asked for the Norms and that they had no legal status. John Ruggie was subsequently given his mandate to research the area again and his work finally cumulated in a Policy Framework (In June 2008, John Ruggie presented the report called: "Protect, Respect and Remedy: a Framework for Business and Human Rights", A/HRC/8/5 (7 April 2008), available at: <http://www.business-humanrights.org/Links/Repository/965591> (last accessed: 09/04/2013) and the Guiding Principles for the implementation of the framework. The Guiding Principles contain 29 Principles which outline how states and businesses should ensure business respect for human rights. See: 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework', available at: <http://www.business-humanrights.org/SpecialRepPortal/Home/Protect-Respect-Remedy-Framework/GuidingPrinciples> (last accessed: 27/04/2013).

<sup>106</sup> See Ruggie's reports in 2006, 2007, 2008, 2009, 2010 and 2011, available at: <http://www.business-humanrights.org/SpecialRepPortal/Home> (last accessed 09/04/2013). See for an overview only: L van den Herik and J Cernik, 'Regulating corporations under international law: from human rights to international criminal law and back again' (2010) *Journal of International Criminal Justice* 725, 735.

<sup>107</sup> J Ruggie, 'The construction of the UN "protect, respect and remedy" framework for business and human rights: the true confessions of a principled pragmatist' (2011) *EHRLR* 127.

<sup>108</sup> J Ruggie, *Protect, Respect and Remedy: a Framework for Business and Human Rights*, (7 April 2008), para 9, available at: <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf> (last accessed: 09/04/2013).

<sup>109</sup> Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, 21<sup>st</sup> March 2011, available at: [http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf) (last accessed: 09/04/2013).

<sup>110</sup> 'New Guiding Principles on Business and Human Rights endorsed by the UN Human Rights Council', see: <http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=11164&LangID=E> (last accessed: 09/04/2013).

<sup>111</sup> See: K Buhmann, 'Integrating human rights in emerging regulation of corporate social responsibility: the EU case' (2011) 7 (2) *International Journal of Law in Context* 139, 142.

<sup>112</sup> J Ames, 'Taking responsibility' (2011) *European Lawyer* 15, 15.

<sup>113</sup> J Ruggie, 'The construction of the UN "protect, respect and remedy" framework for business and human rights: the true confessions of a principled pragmatist' (2011) 2 *EHRLR* 127, 129.

introduction to the Guiding Principles emphasises that the normative contribution of the Guiding Principles lies not in the creation of new international law obligations, but in elaborating the implications of existing standards and practices for states and businesses.<sup>114</sup>

The Guiding Principles are intended to be implemented by countries and by companies.<sup>115</sup> In its 2011 Communication on CSR, the EU Commission has stressed that it seeks to support the implementation of the Guiding Principles and it has invited EU Member States to develop national plans by the end of 2012 for the implementation of the UN Guiding Principles into domestic law.<sup>116</sup> The UK government has made a political commitment to the Guiding Principles.<sup>117</sup> However, at the time of writing, it has not yet published its national plan. As the Guiding Principles highlight, inter alia, the importance of home state regulation for the protection of human rights from business conduct, national private law could be an important part of this home state regulation. Private law could be used by the UK government to implement the Guiding Principles into English law. Due to their topicality and importance for CSR, and also the secondary research question, the UN Guiding Principles will be briefly outlined here. With regard to the first pillar, the state duty to protect human rights, the recommendations in the Guiding Principles contain operational principles about the ways in which states could meet their duty to protect human rights.

Principle 3 provides that, in meeting their duty to protect, States should:

- (a) Enforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights, and periodically to assess the adequacy of such laws and address any gaps;
- (b) Ensure that other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights;

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<sup>114</sup> J Ruggie, Introduction to the Guiding Principles, para 14.

<sup>115</sup> Office of the United Nations High Commissioner for Human Rights, 'New Guiding Principles on Business and Human Rights endorsed by the UN Human Rights Council', available at: <http://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=11164> (last accessed: 10/04/2013).

<sup>116</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A renewed EU strategy 2011-14 for Corporate Social Responsibility', COM (2011) 681 final, para 4.8.2., available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF> (last accessed: 09/04/2013).

<sup>117</sup> UK Trade & Investment, 'Business and Human Rights': 'The Government is fully committed to implementing the Guiding Principles as part of its strategy on business and human rights and expects UK businesses to operate at all times in a way respectful of human rights whether in Britain or overseas.', see: [http://www.ukti.gov.uk/de\\_de/export/howwehelp/overseasbusinessrisk/item/print/308520.html?null](http://www.ukti.gov.uk/de_de/export/howwehelp/overseasbusinessrisk/item/print/308520.html?null) (last accessed: 16/02/2013); Foreign Office Minister Jeremy Browne, 'A UK vision for business and human rights', Speech delivered on 6 July 2012, available at: <https://www.gov.uk/government/speeches/a-uk-vision-for-business-and-human-rights?view=Speech&id=784585582> (last accessed: 09/04/2013).

- (c) Provide effective guidance to business enterprises on how to respect human rights throughout their operations;
- (d) Encourage, and where appropriate require, business enterprises to communicate how they address their human rights impacts.<sup>118</sup>

The commentary to Principle 3 (a) emphasises that there is often a ‘significant failure to enforce existing laws that directly or indirectly regulate business respect for human rights’.<sup>119</sup> The commentary goes on to mention the examples of non-discriminatory and labour laws, as well as environmental, property, privacy and anti-bribery laws. States should consider whether these laws provide the necessary coverage and are being enforced effectively.

In its second pillar, the Guiding Principles also provide a set of recommendations as to how corporations should meet their duty to respect human rights.<sup>120</sup> These principles outline how corporations ought to avoid infringing the human rights of others and how they should address their human rights impact. Notably, the commentary emphasises that the responsibility of corporations to respect human rights ‘is a global standard of expected conduct for all business enterprises which exists independently of states’ abilities to fulfil their own human rights obligations and does not diminish those obligations’.<sup>121</sup> Moreover, this responsibility of corporations would exist over and above compliance with national laws and regulations protecting human rights.<sup>122</sup> As the principles pertaining to the responsibility of companies goes beyond what is necessary to comply with national laws, the implications of the second pillar for English private law are limited.<sup>123</sup>

The third area of the Guiding Principles concerns the need for greater access by victims to effective remedies, both judicial and non-judicial. States are required, as part of their duty to protect against business-related human rights abuses, to provide sufficient access to effective remedies for victims of such abuses that occur within their territory and/or jurisdiction through judicial, administrative or other appropriate means.<sup>124</sup> Access to justice has both procedural and substantive aspects. The operational principles distinguish between three different aspects: First, state-based

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<sup>118</sup> Principle 3 of the UN Guiding Principles.

<sup>119</sup> Principle 3, Commentary.

<sup>120</sup> Principles 11 – 24 of the UN Guiding Principles.

<sup>121</sup> Principle 11, Commentary.

<sup>122</sup> *ibid.*

<sup>123</sup> The implications of the recommendations in the Guiding Principles are here rather discussed in relation to the first pillar (‘The state duty to protect human rights’) and the third pillar (‘Access to remedy’). See for a discussion of the second pillar: P Muchlinski, ‘Implementing the New UN Corporate Human Rights Framework: Implications for Corporate Law, Governance, and Regulation’ (2012) 22 (1) *Business Ethics Quarterly* 145.

<sup>124</sup> Principle 25 of the UN Guiding Principles.

judicial mechanisms<sup>125</sup>; secondly, state-based non-judicial grievance mechanisms<sup>126</sup>; thirdly, non-state-based grievance mechanisms.<sup>127</sup>

### 2.3.1.2 Organisation for Economic Co-operation and Development

Another important international initiative for CSR are the OECD Guidelines for Multinational Enterprises which were first published in 1976<sup>128</sup> and most recently updated in 2011.<sup>129</sup> The negotiators of the Guidelines were the participating countries of the OECD, business associations, trade unions and some civil society organisations.<sup>130</sup> The Guidelines contain voluntary recommendations on human rights, employment, industrial relations, the environment, bribery and consumer interests. The Guidelines make direct reference to some important international instruments such as the Universal Declaration of Human Rights and the ILO Declaration on Fundamental Principles and Rights at Work. These recommendations only address corporations whose headquarters are in states which adhere to the OECD Guidelines. Complaints can therefore only be brought against companies from those countries. It has been regarded as positive though that the OECD Guidelines apply 'both to the Member States in charge of implementing them and to the multinational enterprises whose activities these Guidelines are supposed to govern (whether they operate on the territory of a member country or are based there)'.<sup>131</sup> The OECD Guidelines have in recent versions involved the creation of National Contact Points as a 'follow-up' mechanism.<sup>132</sup> The National Contact Points are responsible for encouraging adherence to the principles. They mediate disputes in case of alleged non-adherence to the Guidelines. Complaints can be filed before such a National Contact Point. Civil society organisations have had access to this complaint procedure since 2000. The UK National Contact Point is a non-judicial mechanism

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<sup>125</sup> Principle 26 of the UN Guiding Principles.

<sup>126</sup> Principle 27 of the UN Guiding Principles.

<sup>127</sup> Principle 28 of the UN Guiding Principles.

<sup>128</sup> Organisation for Economic Cooperation and Development Guidelines for Multinational Enterprises (1976) 15 I.L.M. 9

<sup>129</sup> The OECD Guidelines for Multinational Enterprises. The text of the revised version of the OECD Guidelines for Multinational Enterprises is available at [http://www.oecd.org/document/28/0,3746,en\\_2649\\_34889\\_2397532\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html) (last accessed 09/04/2013).

<sup>130</sup> O Amao, 'The foundation of a global company law for multinational corporation' (2010) *ICCLR* 275, 280.

<sup>131</sup> Y Queinnec, *The OECD Guidelines for Multinational Enterprises: An Evolving Legal Status* (Sherpa 2007) 6.

<sup>132</sup> I Bantekas, 'Corporate Social Responsibility in International Law' (2004) 22 *Boston University International Law Journal* 309, 319.

that does not have powers of enforceability and cannot impose sanctions on non-complying companies, but it can investigate complaints.<sup>133</sup>

### 2.3.1.3 International Labour Organisation

The International Labour Organisation's (ILO) Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (Tripartite Declaration) aims 'to encourage the positive contribution which multinational enterprises can make to economic and social progress and to minimise and to resolve the difficulties to which their various operations give rise'.<sup>134</sup> It was published in 1978 and amended in 2001 and 2006.<sup>135</sup> The amended version makes reference to the ILO's 1998 Declaration on Fundamental Principles and Rights at Work.<sup>136</sup> The Tripartite Declaration contains fundamental principles in the fields of employment, training, working conditions and industrial relations. The ILO Tripartite Declaration is comparable to the OECD Guidelines insofar as it is intended to be non-binding.<sup>137</sup> The Declaration consequently lacks an enforcement mechanism for its provisions.<sup>138</sup>

### 2.3.2 European Union level

The EU addressed the CSR agenda later than the UN, OECD and ILO.<sup>139</sup> The European Commission summarised its view on CSR in a Green Paper entitled 'Promoting a European Framework for Corporate Social Responsibility', published in 2001. As indicated above, the Commission defined CSR in this Green Paper as a 'voluntary concept'.<sup>140</sup> The Green Paper focuses on the 'business case' for CSR.<sup>141</sup> The aim of the Green Paper was to start a debate on CSR, rather than 'making concrete proposals for action'.<sup>142</sup> Hence, the Green Paper recommends companies

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<sup>133</sup> See C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) 31 *Company Lawyer* 172, 176.

<sup>134</sup> ILO Tripartite Declaration, (1978) 17 ILM 422, para 2.

<sup>135</sup> [http://www.ilo.org/empent/Publications/WCMS\\_094386/lang--en/index.htm](http://www.ilo.org/empent/Publications/WCMS_094386/lang--en/index.htm) (last accessed 09/04/2013).

<sup>136</sup> Adopted at the 86<sup>th</sup> session of the International Labour Conference, Geneva, 18 June 1998.

<sup>137</sup> W Kaleck and M Saage-Maass, 'Corporate accountability for human rights violations amounting to international crimes: the status quo and its challenges' (2010) *Journal of International Criminal Justice* 699.

<sup>138</sup> O Amao, 'The foundation of a global company law for multinational corporation' (2010) *ICCLR* 275, 280.

<sup>139</sup> See S Sheikh, 'Promoting corporate social responsibilities within the European Union' (2002) *ICCLR* 143.

<sup>140</sup> European Commission, 'Green paper: Promoting a European framework for Corporate Social Responsibility' COM (2001) 366 final, 20.

<sup>141</sup> See generally S MacLeod, 'Reconciling Regulatory Approaches to Corporate Social Responsibility: The European Union, OECD and United Nations compare' (2007) 13 *European Public Law* 671, 681.

<sup>142</sup> European Commission, 'Green paper: Promoting a European framework for Corporate Social Responsibility' COM (2001) 366 final, 23; see the discussion in A Voiculescu, 'The other European framework for corporate social responsibility: from the Green Paper to new uses of human rights instruments' in D Mc Barnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 379.

to subscribe to existing international CSR standards, rather than develop their own ones.<sup>143</sup> The Commission goes beyond its approval of voluntary CSR approaches by expecting companies to observe national and international legislation, including human rights principles.<sup>144</sup> Further support for a voluntary approach to CSR can be found by the recommendations of the EU-Multi Stakeholder Forum on CSR which reported its conclusions in June 2004.<sup>145</sup> Its underlying aim was to consider the integration of CSR into all EU policies.<sup>146</sup> Notably, the position of the European Parliament in the CSR debate diverged from the Commission's approach as it has always favoured a regulatory approach to CSR.<sup>147</sup> The European Parliament suggested to the Commission that it should take inspiration from best practice at domestic level (which is not always purely voluntary).<sup>148</sup>

Following the global financial crisis, the Commission published Green Papers on corporate governance in 2010-2011 in which it identified governance shortcomings in the financial industry and it also considered broader corporate governance reforms for companies generally.<sup>149</sup> Moreover, the Commission also released a new communication on CSR in 2011 which contains an action agenda for the period 2011-2014.<sup>150</sup> The CSR policy outlined in the communication addresses a number of factors that, in the Commission's view, 'will help to further increase the impact of its CSR policy', including improved company disclosure on social and environmental information.<sup>151</sup> Among the points in the communication is the notion that public authorities should 'where necessary' complement voluntary CSR policies through regulation that, for example, promote transparency or create market incentives for

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<sup>143</sup> European Commission, 'Green paper: Promoting a European framework for Corporate Social Responsibility' COM (2001) 366 final, 9, 16.

<sup>144</sup> A Voiculescu, 'The other European framework for corporate social responsibility: from the Green Paper to new uses of human rights instruments' in D Mc Barnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 381.

<sup>145</sup> S MacLeod, 'Reconciling Regulatory Approaches to Corporate Social Responsibility: The European Union, OECD and United Nations compared' (2007) 13 *European Public Law* 671, 684.

<sup>146</sup> See for a detailed discussion only S MacLeod, 'Reconciling Regulatory Approaches to Corporate Social Responsibility: The European Union, OECD and United Nations compared' (2007) 13 *European Public Law* 671, 682.

<sup>147</sup> A Voiculescu, 'The other European framework for corporate social responsibility: from the Green Paper to new uses of human rights instruments' in D Mc Barnet, A Voiculescu and T Campbell (eds.), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 383.

<sup>148</sup> European Parliament, 'Resolution on EU standards for European enterprises operating in developing countries: Towards a European Code of Conduct' (INI/1998/2075) 18.

<sup>149</sup> European Commission, 'The EU Corporate Governance Framework' COM (2011) 164, available at: [http://ec.europa.eu/internal\\_market/company/docs/modern/com2011-164\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf) (last accessed 09/04/2013).

<sup>150</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and social committee and the committee of the regions: A renewed EU strategy 2011-14 for Corporate Social Responsibility' COM (2011) 681 final, available at: [http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index_en.htm) (last accessed: 09/04/2013).

<sup>151</sup> *ibid*, para 2.

responsible business conduct.<sup>152</sup> With this point the Commission underlines its slight deviation from its previous insistence that CSR was purely voluntary (as also indicated in the Commission's new definition of CSR, mentioned above). Moreover, the Commission seeks to improve self- and co-regulation processes and it has launched a process with enterprises and other stakeholders in this respect.<sup>153</sup> Overall, the communication does not significantly deviate from the Commission's previous CSR policies. In particular, the Commission does not propose the introduction of any specific Europe-wide CSR regulation.

In December 2012, the Commission released an action plan on European company law and corporate governance in which it announced that it would make a proposal in 2013 to strengthen disclosure requirements on board diversity policy and risk management.<sup>154</sup> In February 2013, the EU Parliament adopted two resolutions in which it highlights the importance of company transparency on environmental and social matters.<sup>155</sup> The EU Parliament asked the Commission to bring forward a proposal on non-financial disclosure by companies. In April 2013, the Commission proposed a directive regarding disclosure of nonfinancial and diversity information by certain large companies and groups.<sup>156</sup> The proposed directive, if introduced, would require large companies with more than 500 employees<sup>157</sup> to disclose relevant and material environmental and social information in their annual reports.<sup>158</sup>

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<sup>152</sup> *ibid*, para 3.4.

<sup>153</sup> *Ibid*. para 4.3.

<sup>154</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies' COM (2012) 740 final, para 2.1., available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF> (last accessed: 21/05/2013).

<sup>155</sup> The resolutions passed on 6<sup>th</sup> February are: First, Report on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth (2012/2098(INI)); Committee on Legal Affairs, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0017+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013); Secondly, Report on Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery (2012/2097(INI)); Committee on Employment and Social Affairs, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0023+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013).

<sup>156</sup> European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' COM (2013) 207 final, available at: [http://ec.europa.eu/internal\\_market/accounting/docs/non-financial-reporting/com\\_2013\\_207\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf) (last accessed: 19/05/2013).

<sup>157</sup> And who, during the financial year, exceed on their balance sheet dates either a balance sheet total of EUR 20 million or a net turnover of EUR 40 million.

<sup>158</sup> The proposed Directive stipulates that the annual report of these companies must include a non-financial statement containing information relating to at least environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters. This statement must include a description of the policy pursued by the company in relation to these matters, the results of these policies and the risks related to these matters and how the company manages those risks. Companies that do not pursue policies in relation to one or more of these matters shall provide an explanation for not doing so, Article 1 (1) (a) of the proposed Directive.

This proposed reporting duty is significant for CSR as the issues that companies would have to report on overlap with CSR matters.

### **2.3.3 Domestic legislation in English law**

There have been attempts by CSR campaigners in the UK to put CSR into formal legislation. The Corporate Responsibility (CORE) Coalition has so far developed two separate Corporate Responsibility Bills in the UK which were introduced into Parliament by Private Members' Bills: The first one in 2003 and the second one in 2004.<sup>159</sup>

The first Bill was introduced by Linda Perham MP in 2003 and the second by Andy King MP in 2004. The aim of the 2003 version was to strengthen the transparency of companies about CSR (through, for instance, mandatory reporting provisions), an extension of directors' duties to take account of the environmental and social impact of their conduct and a statutory obligation to pay compensation to those injured or harmed as a result of group management failure.<sup>160</sup> A particular aim of this Bill was, in case of a parent company based in the UK with subsidiaries abroad, to impose a duty on the parent company to ensure that its foreign subsidiaries comply with the Act. This Bill did not succeed, however, partly due to the ongoing process of reviewing the Companies Act at that time. The Companies Act review process included discussions about an extension of directors' duties to consider the impact of the corporation on their stakeholders as well as debates about an inclusion of reporting duties about CSR matters.<sup>161</sup> The 2004 Bill, which also failed, proposed a stronger reporting system about environmental and social impacts which was mainly based on mandatory reporting obligations.<sup>162</sup>

Despite the absence of a specific CSR Act in domestic English law one can now find sections in the Companies Act (CA) 2006 which have relevance for CSR. The new directors' duty in s172 CA 2006 ('Duty to promote the success of the company') states that a director 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. The section enumerates several factors to which directors should have regard when making their decisions, such as the likely consequences of any decision in the long term, the interests of employees and the impact on the environment. The list is non-exhaustive. This provision embodies the 'enlightened

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<sup>159</sup> Both bills can be viewed at <http://www.publications.parliament.uk> (last accessed 09/04/2013).

<sup>160</sup> Sections 3, 4, 5, 6 and 7 of the 2003 Bill.

<sup>161</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 169.

<sup>162</sup> See <http://www.corporate-responsibility.org> (last accessed 09/04/2013).



shareholder value theory' that underlies the Companies Act 2006.<sup>163</sup> It has been argued that, with its emphasis on various factors that a director must take into account when making a decision, s172 CA would be 'stakeholder sensitive', 'relational' and 'more explicitly long term'.<sup>164</sup> The exact scope of this duty will be analysed below. It is sufficient to note here that, whilst there are criticisms about the enforceability of this duty, the list of factors to which a director must have regard overlaps with the objects of CSR.

The second part of the CA 2006 which is relevant for CSR is the reporting duty contained in s417 CA. This section requires directors to include a business review into their directors' report.<sup>165</sup> It is the purpose of the business review is 'to inform members of the company and help them assess how the directors have performed their duty to promote the success of the company under section 172 CA'.<sup>166</sup> The business review is significant for CSR due to the overlap between the list of factors in s172 CA and CSR.<sup>167</sup>

Another means to hold corporations liable in private law is through torts law. A company is vicariously liable in tort for the wrongful acts of an agent or employee acting within the scope of his authority or in the course of his employment. Tort law and CSR overlap where tort law provides causes of action for corporate conduct that constitutes violations of CSR principles. Different causes of action in tort such as negligence, private nuisance or battery could therefore provide remedies vis-à-vis companies that have violated CSR principles. The use of sophisticated group structures by many companies constitutes a challenge for the tort liability of parent companies for torts committed by their subsidiaries. The position in English law is that companies in a group of companies are separate legal entities.<sup>168</sup> However, the recent decision in *Chandler v Cape plc* established that a parent company may be directly liable in negligence to the employees of its subsidiary (to whom it may owe a direct duty of care) irrespective of the separate legal personality of its subsidiary.<sup>169</sup> This decision is significant in terms of CSR promotion, as it could establish

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<sup>163</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 229.

<sup>164</sup> *ibid.*

<sup>165</sup> The chapter on company law and corporate governance will address the proposed changes to narrative reporting that would replace the business review by a strategic report.

<sup>166</sup> S417 (2) CA.

<sup>167</sup> Following a consultation process on narrative reporting in the UK, the government has proposed to replace the business review by a strategic report, see discussion in chapter 3.

<sup>168</sup> *Adams v Cape Industries plc* [1990] BCLC 479.

<sup>169</sup> [2012] EWCA Civ 525. There have been some comments in the literature about the case, see for example: J Fulbrook, 'Chandler v Cape: personal injury: liability: negligence' [2012] *Journal of Personal Injury Law* C135; E McGaughey, 'Donoghue v Salomon in the High Court (Case Comment)' (2011) 4 *Journal of Personal Injury Law* 249.

principles for the future liability of parent companies in tort to the employees of their subsidiaries for conduct that violates CSR principles.

Another example of domestic law playing a role in terms of CSR is the use of consumer protection laws and competition laws to hold corporations accountable for false advertisement.<sup>170</sup> Such claims could be made against a company that violates commitments that it has made in a code of conduct, for example where a company pledges in a code of conduct to respect human rights in its business practice, but is actually involved in the commission of international crimes.<sup>171</sup> There is only very limited case law available so far.<sup>172</sup> The legal bases in this area are the EU Directive on unfair commercial practices (Directive 2005/29/EC), implemented through the Consumer Protection from Unfair Trading Regulations 2008 and the EU Directive concerning misleading and comparative advertising (Directive 2006/114/EC), implemented through the Business Protection from Misleading Marketing Regulations 2008. The Consumer Protection from Unfair Trading Regulations 2008 prohibit misleading actions, including the failure by a trader to comply with a firm and verifiable commitment contained in a code of conduct with which he has undertaken to comply. Notably, in March 2012, the Law Commission recommended the introduction of consumer redress for misleading and aggressive practices.

Finally, English contract law could also play a part in the promotion of CSR in domestic English law. The rules provided by contract law are already used by companies in their supply chain contracts to incorporate CSR standards.<sup>173</sup> As companies understand their supply chain as an area of reputational risk, they increasingly incorporate CSR obligations into the contracts with their suppliers.<sup>174</sup> Contract law is therefore an area of domestic law that could be part of the regulatory framework of CSR.

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<sup>170</sup> See C Glinski, 'Corporate codes of conduct: moral or legal obligation?' in D Mc Barnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 126.

<sup>171</sup> W Kaleck and M Saage-Maass, 'Corporate accountability for human rights violations amounting to international crimes: the status quo and its challenges' (2010) *Journal of International Criminal Justice* 699, 718.

<sup>172</sup> C Glinski, 'Corporate codes of conduct: moral or legal obligation?' in D Mc Barnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 126.

<sup>173</sup> D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and "other-regulation"' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 59.

<sup>174</sup> *ibid.*, 63.

Corporations can also be criminally liable for violations of CSR principles, for example for the use of physical force against employees.<sup>175</sup> Companies can commit crimes, although some offences cannot be committed by companies due to their nature. If criminal liability is to have a wide reach, it is necessary that the acts of the company's employees, agents or officers are attributed to the company.<sup>176</sup> The Corporate Manslaughter and Corporate Homicide Act 2007 (CMCHA) makes corporate manslaughter an offence, provided that the company's activities are managed or organised in a way that causes a person's death and amounts to a gross breach of a relevant duty of care owed by the company to that person.<sup>177</sup> The offence presupposes that the way in which the company's activities are managed or organised by its senior management is a substantial element in the breach of the duty of care.<sup>178</sup> English multinational corporations also face liability under the recently introduced Bribery Act.<sup>179</sup> Common to all cases of bribery outlined in the Act is the offer or taking of a 'financial or other advantage'.<sup>180</sup> The Bribery Act creates four offences: paying bribes, receiving bribes, the offence of bribing a foreign public official and the failure of a commercial organisation to prevent bribery. One of the penalties is the disqualification of directors under the Companies Disqualification Act 1986. The Act has a near-universal jurisdiction, allowing for the prosecution of an individual or company with links to the United Kingdom, regardless of where the crime occurred. Section 7 makes it an offence for commercial organisations which have business in the UK to fail to prevent bribery on their behalf. This offence does not only apply to the organisation itself; individuals and employees may also be guilty. Although the Bribery Act is criminal law and hence not private law, it is

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<sup>175</sup> See for an overview of the criminal liability of corporations: D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 19.8.4. The criminal liability of corporations is discussed in the context of CSR in: A Voiculescu, 'Changing paradigms of corporate criminal responsibility: lessons for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 399.

<sup>176</sup> The leading case regarding the rules of attribution is now *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 BCLC 116, PC. Lord Hoffmann held that it is for the court to ask whose act or knowledge or state of mind is for the purpose of that rule intended to count as the act, knowledge or state of mind of the company, applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its contents and policy. Before this decision the leading rule for the attribution was the identification theory with the 'directing mind and will of the company' test, established in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705, 713. According to this test, the directing mind and will must 'be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.' In *Tesco Supermarkets v Natrass* [1972] AC 153 it was held that the identification of the directing mind and will is usually the board of directors and not junior management.

<sup>177</sup> s1 (1) CMCHA.

<sup>178</sup> s1 (3) CMCHA.

<sup>179</sup> Bribery Act 2010, available at: [www.legislation.gov.uk/ukpga/2010/23/pdfs/ukpga\\_20100023\\_en.pdf](http://www.legislation.gov.uk/ukpga/2010/23/pdfs/ukpga_20100023_en.pdf) (last accessed 03/10/2011).

<sup>180</sup> G Sullivan, 'Legislative comment: The Bribery Act 2010: Part 1: an overview' [2011] *Criminal Law Review* 87, 89.

important for this thesis for two reasons. First, it supports the view taken here that CSR is, at least in part, law, given that the prevention of bribery is one of the aims of CSR. Secondly, the existence of the Bribery Act raises the issue of whether there is also civil liability for bribery.<sup>181</sup>

#### 2.3.4 Private regulation

Private regulation describes normative settings which are not provided for by state based decision-making, but by voluntary decisions of non-public actors such as corporations or NGOs which create general rules beyond single contracts.<sup>182</sup> Private CSR regulation inter alia consists of codes of conduct<sup>183</sup> and labelling schemes<sup>184</sup>. Private regulation plays an increasingly important role for CSR. The general proliferation of private regulation in CSR in recent years is due to the influence of non-state actors, such as NGOs or corporations themselves. NGOs, in particular, are said to have transformed CSR 'from a fringe concern to a mainstream policy issue'.<sup>185</sup> NGOs document cases and monitor adherence to CSR standards.<sup>186</sup> For example, when producers meet the standards of private regulatory initiatives, they receive a certificate or label.<sup>187</sup>

The area of private regulation is not homogenous, as CSR standards and codes of conduct are not only developed by corporations themselves<sup>188</sup>, but also at industry level or by NGOs. This has led to calls to 'disentangle' the private sphere.<sup>189</sup> Abbott and Snidal have developed a conceptual map to classify the different private regulatory regimes. They have created a 'governance triangle' by distinguishing

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<sup>181</sup> The High Court discussed this recently in the case *Fiona Trust & Holding Corp v Privalov* [2010] EWHC 3199 (Comm). Where a principal unknowingly uses an agent (who may be an employee of the principal) who accepts a bribe from a third party in order to secure a contract for the third party, a civil right of action also arises. The person receiving the bribe can be required to account to the principal for the amount of the bribe received and, where appropriate, for damages. Furthermore, the principal is entitled to rescind a contract procured by bribery and to refuse to perform their obligations under it on the ground that it is an illegal contract.

<sup>182</sup> D Schiek, 'Private rule-making and European governance – issues of legitimacy' (2007) 32 *European Law Review* 443, 444.

<sup>183</sup> e.g. Amnesty International, 'Human Rights Principles for Companies', available at: <http://www.amnesty.org> (last accessed 09/04/2013).

<sup>184</sup> e.g. the 'green labelling' scheme operated by the Forest Stewardship Council.

<sup>185</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 95.

<sup>186</sup> e.g. European Center for Constitutional and Human Rights, available at: <http://www.ecchr.eu> (last accessed 04/09/2013).

<sup>187</sup> A Marx, 'Global Governance and Private Regulation of Supply Chains – Types, Trends and Challenges' (Antwerp Management School, Working Papers, 2010) 2.

<sup>188</sup> e.g. British American Tobacco, Standards of Business Conduct, available at:

[http://www.bat.com/group/sites/uk\\_\\_3mnfen.nsf/vwPagesWebLive/DO5TXKRH?opendocument&SKN=1&TMP=1](http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO5TXKRH?opendocument&SKN=1&TMP=1) (last accessed 09/04/2013).

<sup>189</sup> See D Vogel, 'The Private Regulation of Global Corporate Conduct' in W Mattli and N Woods (eds), *The Politics of Global Regulation* (Princeton University Press 2009) 156; F Cafaggi, 'New Foundations of Transnational Private Regulation' in C Scott, F Cafaggi and L Senden (eds), *The Challenge of Transnational Private Regulation – Conceptual and Constitutional Debates* (Wiley-Blackwell 2011) 31.

between three major actors, the state, companies and non-governmental organisations which develop rules and standards, either separately or together.<sup>190</sup> Seven zones are distinguished within this triangle, depending on how many parties are involved in defining standards: Three zones consist of initiatives where one actor develops the standards (e.g. OECD Guidelines for Multinational Enterprises, industry-driven initiatives and NGO-driven initiatives), a further three zones consist of initiatives where two actors develop the standards (cooperation between NGOs and the state, initiatives between international authorities and companies such as the UN Global Compact) and one zone contains initiatives developed by the three parties.<sup>191</sup> An example of the latter is the 1977 Declaration of the International Labour Organisations, for it involves all three parties. The focus of this conceptual map is on who develops the initiatives.

In conclusion, the overview of the regulatory framework of CSR in this section has shown that CSR and law, at least have the potential to overlap in various ways, for example, the duty for directors to promote the success of the company for the benefit of its members as a whole in s172 (1) CA or the business review in s417 CA. The overview therefore supports the view taken in this thesis that CSR is, at least in part, law. The outline of the regulatory framework of CSR has particularly shown that private law, the focus of this thesis, plays or at least could play a significant role for CSR. The following section will therefore review the existing legal literature about CSR in light of this regulatory framework. The particular focus of the analysis is the question if and, if so, how the existing literature comprehends the role of private law in this regulatory framework.

## **2.4 Review of the literature on CSR and the law**

Traditionally, the literature on CSR and the law was very much captured in binary debates and tended to take place in separate spheres, for example, discussions about voluntary or mandatory approaches to CSR. A reason for this situation is, as Horrigan has noted, that 'CSR can be studied, regulated and practised from many different angles'.<sup>192</sup> These dichotomies in the CSR debate give some justification to the claim that 'CSR has hardly moved beyond the starting point'.<sup>193</sup>

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<sup>190</sup> K W Abbott and D Snidal, 'Governance triangle' in W Mattli and N Woods (eds), *The Politics of Global Regulation* (Princeton University Press 2009) 50.

<sup>191</sup> *ibid.*

<sup>192</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) p ix.

<sup>193</sup> C Villiers, 'Corporate law, corporate power and corporate social responsibility' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 97.

### 2.4.1 Classic binary debates between a mandatory and a voluntary approach

Traditionally, discussions on CSR and the law were strongly influenced by the debate whether or not CSR should be voluntary or mandatory (also referred to as 'hard law' or 'soft law' approaches to CSR). It has been said that this debate continues to divide CSR professionals.<sup>194</sup> Ward states that the basic dividing line is between people who argue that CSR should be limited to voluntary activities beyond compliance and those who argue for a broader starting point.<sup>195</sup>

On one side of this debate are those who argue for a 'soft law' approach to CSR, based on self-regulation.<sup>196</sup> Proponents of this approach commonly point out that state law that forces companies to pursue CSR goals would be overly legalistic and complicate the running of business.<sup>197</sup> It is often argued that the goal of wealth maximisation must always be the most useful touchstone for managers.<sup>198</sup> A consequence of this approach is to refrain from imposing CSR-related duties on directors. According to this view, self-regulation is the best way to meaningfully approach CSR as it allows each corporation to adapt CSR to its particular situation thereby offering flexibility without being overly restrictive. This approach is based on the idea of the business case for CSR.<sup>199</sup> The business case argument means that being socially responsible will be economically beneficial for the company in the long run.<sup>200</sup> State regulation is seen as burdensome and as reducing the competitiveness of firms. This position is generally based on a neo-liberal attitude to business regulation.<sup>201</sup> Its effect is to separate law and CSR. Moreover, authors writing from a socio-legal perspective share the scepticism about a mandatory approach to CSR and look for alternatives to law.<sup>202</sup> They often see law as being ineffective to guide

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<sup>194</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 32.

<sup>195</sup> C Ward, 'Legal Issues in Corporate Citizenship', (2003) *Swedish Partnership for Global Responsibility*, iii, available at: <http://pubs.iied.org/pdfs/16000IIED.pdf> (last accessed 03/06/2013).

<sup>196</sup> See The Confederation of Business Industry (CBI), available at: <http://www.cbi.org.uk/ndbs/content.nsf/802737AED3E3420580256706005390AE/9D502144AC9F644380256F58005BD16C> (last accessed 03/10/2012); Department for Business, Innovation and Skills, <http://www.bis.gov.uk/policies/business-sectors/low-carbon-business-opportunities/sustainable-development/corporate-responsibility> (last accessed 03/10/2011).

<sup>197</sup> A Lumsden and S Fridman, 'Corporate Social Responsibility: the case for a self-regulatory model' (The University of Sydney Law School, Legal Research Studies Paper No. 07/34, 2007) 31.

<sup>198</sup> *ibid.*

<sup>199</sup> Business in the Community, *The Business Case for being a Responsible Business* (London 2011), available at: [http://www.bitc.org.uk/resources/publications/the\\_business\\_case.html](http://www.bitc.org.uk/resources/publications/the_business_case.html) (last accessed 03/10/2011).

<sup>200</sup> See D Vogel, 'Is there a market for virtue: The business case for corporate social responsibility' (2005) 47 *California Management Review* 19.

<sup>201</sup> See S MacLeod, 'Reconciling Regulatory Approaches to Corporate Social Responsibility: The European Union, OECD and United Nations compared' (2007) 13 *European Public Law* 671, 673.

<sup>202</sup> See the discussion in C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the 'Heineken effect' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 173-174.

human behaviour.<sup>203</sup> Many socio-legal scholars are also critical of the ability of government departments to set and enforce rules as companies can find ways to comply with the letter of the law, but not its spirit.<sup>204</sup> From this perspective, a mandatory approach to CSR alone does not change social practice.

On the other side of the debate, there are those who are critical of the mainly voluntary status quo and who argue for a 'hard law' approach to CSR. Kassahun, for instance, contends that voluntary CSR initiatives 'should supplement, not supplant state regulation'.<sup>205</sup> This view is based on the argument that host states of multinational enterprises and their subsidiaries/suppliers in the developing world often have a low level of human rights protection and/or a weak system of law enforcement. These states are often too weak in comparison with the power wielded by some multinational companies to adequately protect CSR principles. Consequently, voluntary CSR standards would not be a sufficiently potent instrument of control.<sup>206</sup> It would only produce few results. It is argued that the control of business is still a matter for the state for reasons of effectiveness, legitimacy and accountability.<sup>207</sup> Mandatory CSR rules would create rights that are enforceable through litigation.<sup>208</sup> One of the key arguments in favour of such an approach is the poor results of the current voluntary, private initiative-based CSR framework.<sup>209</sup> Multinational enterprises have not fulfilled the self-imposed, voluntarily adopted CSR standards to which they pledged to adhere. It is therefore significant that, despite the academic interest in private CSR standards (also referred to as part of new forms of governance)<sup>210</sup>, calls for a legalistic binding CSR framework have not disappeared.<sup>211</sup> Instead, they are still frequent<sup>212</sup> and indeed more diverse now with different suggestions as to the binding solutions.<sup>213</sup> Pedamon makes such a suggestion by arguing for a regulatory framework with a minimum definition of CSR

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<sup>203</sup> *ibid.*

<sup>204</sup> *ibid.* The socio-legal literature on the relationship between law and CSR is discussed in section 2.4.2.

<sup>205</sup> Y Kassahun et al., 'Putting regulation before responsibility: The Limits of Voluntary Corporate Social Responsibility' (2005) 2 *Voices of Development Jurists*.

<sup>206</sup> *ibid.*

<sup>207</sup> *ibid.*

<sup>208</sup> See S MacLeod, 'Reconciling Regulatory Approaches to Corporate Social Responsibility: The European Union, OECD and United Nations compared' (2007) 13 *European Public Law* 671, 674.

<sup>209</sup> C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) 31 *Company Lawyer* 172, 177.

<sup>210</sup> The literature about private regulation is discussed below in this section.

<sup>211</sup> See for a recent contribution: A Kakabadse and N Kakabadse, 'CSR in the Boardroom: Myth or Mindfulness' in A Kakabadse and N Kakabadse (eds), *CSR in Practice* (Palgrave Macmillan 2007); C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) 31 *Company Lawyer* 172, 180.

<sup>212</sup> See E Emesehe et al., 'Corporations, CSR and Self-Regulation: What Lessons From the Global Financial Crisis?' (2010) 11 *German Law Journal* 230, 258.

<sup>213</sup> See C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) 31 *Company Lawyer* 172, 179.

standards to 'ensure a level playing field'.<sup>214</sup> Companies could then define their own standards within this framework. She stresses the importance of sanctions to be imposed in the event for non-compliance. Such a system would allow companies to be more specific.<sup>215</sup> Particularly NGOs are sceptical about purely voluntary approaches to CSR. For example, the Corporate Responsibility (CORE) Coalition, argues that 'the voluntary approach to Corporate Responsibility has failed'.<sup>216</sup> According to this perspective, CSR is or should, at least in part, be law.

These two strongly opposed views are representative of classic binary CSR debates. However, some recent literature seems to suggest that the classic 'either...or' approach to the question of how to regulate CSR is losing ground. In respect of the voluntary vs. mandatory debate, Zerk concludes that too many contributions are presented 'with an agenda in mind'.<sup>217</sup> She calls this regulatory CSR debate 'misguided'.<sup>218</sup> It would reflect an 'overly simplistic view of what law is, and how it guides human behaviour'.<sup>219</sup> She particularly criticises that it would separate law from CSR which would overlook the legal developments that have been made in CSR.<sup>220</sup> And, in fact, the danger of this debate is that it presents voluntary CSR commitments and hard law approaches as complete opposites, without realising that there are links and that the legal side of CSR is in evolution. Such binary debates do not take into account, for instance, that CSR enforcement mechanisms have been developed, for example the inclusion of CSR into supply contracts or the recourse to consumer law to enforce compliance with a code of conduct. These regulatory techniques lead to interaction between self-regulation, state law and private law. It is therefore doubtful if the private regulation of CSR can indeed still be regarded as entirely voluntary.<sup>221</sup> Horrigan notes that new regulatory approaches to CSR render the distinction between mandatory and voluntary standard-setting increasingly unsound, even within the existing private initiative-based CSR regime.<sup>222</sup> The strict dichotomy between mandatory legal enforcement of CSR and voluntary corporate assumptions of responsibility would be an

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<sup>214</sup> *ibid.*

<sup>215</sup> P Utting, 'Rethinking Business Regulation: From Self-Regulation to Social Control', (United Nations Research Institute for Social Development, Technology, Business and Society Programme Paper Number 15 September 2005) 8.

<sup>216</sup> See <http://corporate-responsibility.org/> (last accessed 09/04/2013).

<sup>217</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 32.

<sup>218</sup> *ibid.*, 34.

<sup>219</sup> *ibid.*

<sup>220</sup> *ibid.*, 35.

<sup>221</sup> P Muchlinski, 'Corporate social responsibility and international law: the case of human rights and multinational enterprises' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 456.

<sup>222</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 114.



unsatisfactory one. The reason is that voluntary initiatives now increasingly complement mandatory standards.<sup>223</sup> There are also moves towards implementing accountability measures into voluntary initiatives. For instance, sustainability reporting shows a proliferation of external assurance statements, i.e. a third party monitors the report of a company.<sup>224</sup>

The fact that, contrary to its previous definition of CSR, the EU Commission no longer describes CSR as 'voluntary' in its 2011 communication on CSR is a further indication that there is a growing realisation that CSR is, at least, in part law. The classic binary debate between a voluntary or a mandatory approach to CSR has been overcome by the 'reality' of the emerging CSR-regulation that can be found, for example, in the Companies Act (s172: duty to promote the success of the company for the benefit of its members as a whole) or the interaction between private regulation and private law through supply chain contracts. It can therefore be said that the debate about hard law or voluntary approaches to CSR with its 'thinking in bi-polar terms'<sup>225</sup> is outdated. It is now time to overcome dichotomies and instead to discuss 'when and where corporate responsibility strategies are effective and appropriate' regardless of the respective mechanism, given that CSR can be addressed from many different perspectives such as human rights or company law.<sup>226</sup> In light of the regulatory framework of CSR outlined in the previous section, it is important that the literature on CSR and the law must now move on and focus on the overlap between law and CSR as well as the interaction between private regulation and law, particularly within 'hybrid' regulatory approaches to CSR. The term 'hybrid' refers to the combination of different forms of regulation such as private regulation and state law or public law and private law.<sup>227</sup> Pedamon is therefore correct to ask:

One must wonder how public and private ordering can better complement each other. Is it possible to imagine a system where the state legislator would define a binding framework in which private codification would implement and define rules relevant and specific to sector activity and practices? This would thus expand the regulatory impact of legislation and bring legitimacy and credibility to private governance. Companies would be accountable for the violation of, or non-compliance with the binding rules.

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<sup>223</sup> C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) 31 *Company Lawyer* 172, 180.

<sup>224</sup> D Owen and B O'Dwyer, 'Corporate Social Responsibility – The Reporting and Assurance Dimension' in A Crane and others (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 401.

<sup>225</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 122.

<sup>226</sup> A Chaterji and S Listokin, 'Corporate Social Responsibility' (2007) 3 *Democracy: A Journal of Ideas*.

<sup>227</sup> See for a discussion of the term 'hybrid' in relation to regulation: M Vrielink, C van Montfort and M Bokhorst, 'Codes as hybrid regulation' in D Levi-Faur (ed), *Handbook On The Politics Of Regulation* (Edward Elgar 2011) para 35.5.2.

Although Pedamon's contribution is still speculative, it is nevertheless important as she raises the question how the two opposing ends can be brought together to best promote CSR. Horrigan argues in a similar way when he contends that 'mandatory legal regulation is neither the only nor necessarily the best means of ensuring higher standards of corporate behaviour and transparency'.<sup>228</sup> These arguments indicate that it is important to analyse how the combination of private regulation and law (including private law) already promotes or could better promote CSR. This thesis contributes to that important analysis.

#### 2.4.2 The focus on socio-legal perspectives

As early as in the 1990s, Carroll noted that the CSR scholarship is 'an eclectic field with loose boundaries, multiple memberships and different training/perspectives; broad rather than focussed, multidisciplinary; wide breath; brings in a wider range of literature; and interdisciplinary'.<sup>229</sup> In fact, CSR can be studied in a range of subjects and with different methodologies. Consequently, the regulatory framework of CSR has often been approached from socio-legal perspectives.

There are two main approaches in the socio-legal literature about how to analyse the relationship between law and CSR. These are meta-regulation and reflexive governance.<sup>230</sup> Parker defines meta-regulation as 'a descriptive or explanatory term within the literature on "new governance" to consider the way in which the state's role in governance and regulation is changing and splitting'.<sup>231</sup> Meta-regulation denotes the proliferation of different forms of regulation, both state and non-state, which regulate each other.<sup>232</sup> Parker understands meta-regulation as the state regulating its own regulation as well as any form of regulation that regulates any other form of regulation, for example legal regulation of self-regulation, non-legal methods of 'regulating' internal corporate self-regulation or management and the regulation of national law-making by transnational bodies.<sup>233</sup> Her argument is that

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<sup>228</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 65.

<sup>229</sup> A Carroll, 'Social Issues in Management Research' (1994) 33 *Business and Society* 5, 14.

<sup>230</sup> See C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the "Heineken effect"' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 170; C Parker, 'Meta-regulation: Legal accountability for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 207; J Bomhoff and A Meuwese, 'The Meta-regulation of Transnational Private Regulation', in C Scott, F Cafaggi and L Senden (eds), *The Challenges of Transnational Private Regulation: Conceptual and Constitutional Debates* (Wiley-Blackwell 2011) 138.

<sup>231</sup> C Parker, 'Meta-regulation: Legal accountability for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 210.

<sup>232</sup> *ibid.*

<sup>233</sup> *ibid.*

legal accountability for CSR must be aimed at making business enterprises put themselves through a CSR process aimed at CSR outcomes.<sup>234</sup> The process must open up management to external values, stakeholder and regulatory influences. Meta-regulation is an approach to legal regulation in which the 'internal corporate conscience' is externally regulated.<sup>235</sup> The strength of this perspective is that meta-regulation seeks a middle-ground between positive law and self-regulation.<sup>236</sup> It can therefore be a useful tool for the analysis of the regulatory CSR framework and the influences that the different forms of regulation have. Horrigan argues that by applying the theory of meta-regulation to the CSR regulatory framework one would see that an absolute divide between corporate law and non-corporate law would deny their regulatory influences on each other and their combined impact for holistic corporate compliance and risk management.<sup>237</sup>

Another approach to CSR in the socio-legal literature is the use of reflexive governance.<sup>238</sup> Reflexive governance focuses on 'creating structures within which actors such as corporations can reflect on how they see the world'.<sup>239</sup> It looks at the 'inner logic' of social systems<sup>240</sup> and it studies the communicative processes of legal and social systems.<sup>241</sup> The emphasis is rather on procedural norms than on substantive formalised rules.<sup>242</sup> Reflexive governance is about initiating reflexive processes in institutions about how to respond to given problems. State law is only considered to be one form of normative settings among competing systems.<sup>243</sup> Self-regulation is given an important role in this approach. Reflexive governance mobilises the self-referential capacities of institutions to enable them to best shape their response to complex problems. The law does not need to directly regulate complex social areas but focuses on controlling the structure and processes of self-

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<sup>234</sup> C Parker, 'Meta-regulation: Legal accountability for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 237.

<sup>235</sup> *ibid.*

<sup>236</sup> O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries* (Routledge 2011) 75.

<sup>237</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 111.

<sup>238</sup> See G Teubner (ed), *Global Law Without a State* (Brookfield 1997); C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the "Heineken effect"' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 174.

<sup>239</sup> C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the "Heineken effect"' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 174.

<sup>240</sup> C Scott, 'Regulation in the age of governance: The rise of the post-regulatory state', in J Jordana and D Levi-Faur (eds), *The politics of regulation: institutions and regulatory reforms for the age of governance* (Edward Elgar 2004) 145.

<sup>241</sup> R Rogowski and T Wiltthagen, *Reflexive Labour Law* (Kluwer Law and Taxation Publishers 1994) 4.

<sup>242</sup> O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries*, (Routledge 2011) 76.

<sup>243</sup> *ibid.*, 77.

regulation.<sup>244</sup> The interesting aspect of this theory from a CSR point of view is the recognition of self-regulation as one form of normative orders among others.

Both meta-regulation and reflexive governance share the recognition of a variety of normative settings, including self-regulation. They are therefore useful tools in order to understand the complex regulatory framework of CSR with the strong influence of private authority and the various effects that this framework has. However, their usefulness is not undisputed. For instance, criticisms have been made about the effectiveness of reflexive governance with its focus on reflection processes which would not direct substantive outcomes.<sup>245</sup> The process-oriented understanding that these socio-legal frameworks provide is particularly useful to comprehend the interaction of different regulatory CSR tools, in particular how the firm reacts to the adoption of CSR commitments. Nevertheless, these approaches do not sufficiently discuss the *legal* effects of the existing regulatory framework of CSR, for example, what legal duties companies have to be socially responsible or what legal remedies parties procure for violations of CSR principles. A doctrinal perspective would therefore complement the socio-legal methods in the scholarship on CSR and the law. The ways in which law overlaps or at least has the potential to overlap with CSR (e.g. in company law) or in which law is used or at least could be used to promote CSR (e.g. contract law) raise the question if and, if so, how parties can enforce CSR in private law. In particular, the issue is what the contribution of home state regulation is to this emerging CSR framework, including English private law. To that end, a doctrinal perspective with its systematic analysis of primary sources and secondary sources would be a useful addition to the socio-legal literature on CSR regulation.

### **2.4.3 The dominance of international law in the legal literature on CSR**

The existing literature on CSR and the law is primarily written from an international law perspective. The international law literature on CSR clearly outnumbers contributions in private law (including the growing literature in company law). This confirms Zerk's observation: 'So far, international lawyers have proved much more

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<sup>244</sup> M Davis, 'A Crisis of Professional Self-Regulation – the Example of the Solicitors' Profession' (Cardiff Centre for Law and Ethics 2005), available at: [www.ccels.cf.ac.uk](http://www.ccels.cf.ac.uk) (last accessed 06/10/2011).

<sup>245</sup> See C Scott, 'Reflexive governance, meta-regulation and corporate social responsibility: the "Heineken effect"' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 175.

ready to engage with CSR campaigns and debates than their commercial law counterparts, especially in relation to human rights.<sup>246</sup>

The international law literature on CSR particularly addresses the issue that, due to the state-centeredness of international law, multinational enterprises have been able to hide behind the state as they have no legal personality to bear rights or duties under treaty or customary law.<sup>247</sup> CSR challenges the traditional concept of international law as being exclusively inter-state law.<sup>248</sup> Discussions about CSR in international law overlap with the classic debate whether corporations can directly be regulated by international law or only through 'indirect' regulation which means that obligations are imposed on states to control private actors.<sup>249</sup> It has, for instance, been suggested that multinational enterprises should become duty-holders in relation to human rights due to their power.<sup>250</sup> This proposal questions the traditional division of participants in international law into 'subjects' and 'objects' (e.g. companies) with international law not being directly applicable to objects.<sup>251</sup> This division means that companies cannot have duties imposed upon them by international law. Zerk remains sceptical about the benefits of companies being human rights duty-holders as 'although there may be some blurring at the edges, states and companies do perform different roles in society'.<sup>252</sup> Here she refers to the governmental functions of the state and the profit-creation aim of companies. This scepticism is supported by the fact that the 'Norms on the Responsibility of Transnational Corporations and Other Business Enterprises with regard to human rights obligations' failed and that the UN Guiding Principles clearly distinguish between the duties of states to protect human rights and the responsibility of companies to respect human rights. Nevertheless, the literature still proposes solutions in international law for the regulation of multinational corporations.<sup>253</sup> Alice de Jong inter alia suggests broadening the jurisdiction of the International Court of

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<sup>246</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 27.

<sup>247</sup> I Bantekas, 'Corporate Social Responsibility in International Law' (2004) 22 *Boston University International Law Journal* 309, 310.

<sup>248</sup> See J Delbruck, 'Prospects for a "world" (internal) law?: Legal developments in a changing international system' (2002) *Indiana Journal of Global Legal Studies* 401.

<sup>249</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 76.

<sup>250</sup> A Sinden, 'Power and responsibility: why human rights should address corporate environmental wrongs' in

D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 519.

<sup>251</sup> P Muchlinski, 'Human Rights and Multinational Enterprises' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 433.

<sup>252</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 78.

<sup>253</sup> See A de Jong, *Transnational Corporations and International Law: Accountability in the Global Business Environment* (Edward Elgar 2011) 209.

Justice to include transnational corporations.<sup>254</sup> Zerk posits that international law has much potential in relation to CSR, for the soft law tradition of international law can develop into hard law.<sup>255</sup> Amao is rather critical of the results of international law in relation to CSR which he claims to have failed.<sup>256</sup> Instead, he proposes to use international law as a supporting mechanism.<sup>257</sup> In his view, one way in which this could occur would be the introduction of an international company with an international corporate personality which should be analogous to corporate personality under domestic law.<sup>258</sup> This should be part of an international company law framework to fill the regulatory gaps that currently exist with respect to multinational corporations. Amao suggests that member states should not be required, but given the opportunity to incorporate this framework into domestic law.<sup>259</sup> There should be rules pertaining to the liability of parent companies for their subsidiaries. This proposal would establish a uniform standard. It remains to be seen though how likely it is that Amao's proposal is ever going to be implemented.

An interesting feature of Amao's concept is that he includes an expanded role for home states of multinational companies. There seems to be a growing consensus that home states are an important element of the regulatory framework of CSR. Discussions about CSR in international law often discuss whether CSR should be regulated by the host state, the home state or internationally.<sup>260</sup> As regards the host state, there is often a low level of protection due to the importance of the investment by the multinational corporation.<sup>261</sup> The difficulties with regulating host states and the transnational activities of multinational companies have led to calls for international regulation.<sup>262</sup> However, the UN Guiding Principles, too, emphasise the importance of regulation in the home states of multinational enterprises. The Guiding Principles have clearly turned away from the approach taken by the UN Norms which would directly impose duties on companies. If the international law literature on CSR is to

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<sup>254</sup> *ibid*, 206.

<sup>255</sup> J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 4.

<sup>256</sup> O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries* (Routledge 2011) 54.

<sup>257</sup> O Amao, 'The foundation of a global company law for multinational corporations' (2010) *ICCLR* 275, 286.

<sup>258</sup> *ibid*, 275.

<sup>259</sup> *ibid*, 283.

<sup>260</sup> The terms 'home state' and 'host state' are introduced in chapter 1. The home state is considered to be the state in which the multinational corporation is incorporated. In contrast, the host state is the state in which the multinational enterprise, either directly or through its subsidiary, operates. See: B Cragg, 'Home is where the halt is: Mandating Corporate Social Responsibility through home state regulation and social disclosure' (2010) 24 *Emory International Law Review* 735, 751.

<sup>261</sup> See J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 2.

<sup>262</sup> O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries* (Routledge 2011) 23.

follow this approach, than it will need to engage with domestic laws and their potential to promote CSR, either directly or in combination with international law instruments, such as soft law instruments developed by international organisations. This argument supports the view taken in this thesis that English private law plays an important role in the development of the legal CSR framework. The fact that the UK government has made a political commitment to implement the UN Guiding Principles at least potentially further demonstrates their relevance for English law. To some extent, the international law literature on CSR therefore needs to turn its focus to the use of private law to implement private CSR standards as well as CSR standards developed by international organisations. These discussions should explore ways in which international legal CSR standards such as the Global Compact can reach meaningful results.<sup>263</sup> Here, private law could complement international law instruments.

So, whilst it is acknowledged that international law has, at least in theory, 'much potential' to regulate CSR<sup>264</sup>, it must now address the interplay between domestic law and international law, if it is to fully address current developments in the regulatory framework of CSR. This thesis contributes to the analysis of that interplay, by focussing on domestic private law and CSR.

#### **2.4.4. The potential contribution of private law to the promotion of CSR**

The increasing importance of private law for CSR is reflected in some recent monographs which analyse CSR from a variety of standpoints, including international law, but also company law, contract law and tort law.<sup>265</sup> These books are significant for two reasons. First, they aim to look at CSR from different legal standpoints in order to bring scholarship together. This approach is important, as the regulatory framework, discussed in the previous section, has indicated that CSR is a matter which requires holistic approaches. Secondly, these pieces also indicate that CSR is not purely in the international law domain, but rather an issue that affects all branches of the law, including domestic private law. However, in comparison to international law, CSR has so far only played a minor role in the private law

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<sup>263</sup> See B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 170.

<sup>264</sup> *ibid*, 168.

<sup>265</sup> See for example: D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007); N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008); B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> century Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010); O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries* (Routledge 2011).

literature, despite some mentions in company law and corporate governance as well as tort law.<sup>266</sup>

With regard to company law and corporate governance, the social responsibilities of firms already featured in the Berle-Dodd debate in the 1930s about the question in whose interest the company is run<sup>267</sup> and particularly in Friedman's criticism of the CSR agenda in 1962.<sup>268</sup> However, during most of the 1990s and 2000s, CSR was very infrequently expressly mentioned and explored in the English company law and corporate governance literature.<sup>269</sup> The topic somehow disappeared. In particular, the concept of CSR did not play an important role in the review process that led to the Companies Act 2006. It seems as if CSR was in the shadow of discussions about the purpose of the firm during the company law review process. With her comment that CSR is 'now an important topic in its own right'<sup>270</sup>, Hannigan indicates that it was not a priority for company lawyers when the company law review process was in progress during the late 1990s and early 2000s. And where CSR was mentioned, it was understood to be rather interchangeable with 'stakeholder theory'.<sup>271</sup> Although there is a link between discussions about corporate theories and the question if/how a firm must/may engage with CSR<sup>272</sup>, it is important to bear in mind that stakeholder theory is a theory of the firm, whereas CSR is a concept about the responsibilities of the company. This reduction of CSR as being a variant of 'stakeholder theory' has therefore hardly helped to advance the CSR debate in

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<sup>266</sup> See for example: J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35; A Adeyeye, 'The limitations of corporate governance in the CSR agenda' (2010) 31 *Company Lawyer* 114.

<sup>267</sup> A Berle, 'Corporate Powers as Powers in Trust', (1931) 44 *Harvard Law Review* 1049; E M Dodd, 'For whom are corporate managers trustees?' (1932) 45 *Harvard Law Review* 1145. This debate will be addressed in chapter 3 of this thesis ('Company law, corporate Governance and CSR').

<sup>268</sup> M Friedman, *Capitalism and Freedom* (University of Chicago Press 1962) 133.

<sup>269</sup> The terms 'company law' and 'corporate governance' will be differentiated in chapter 3. Parkinson was among those who researched CSR from a company law perspective relatively early in the debate about the reform of English company law. In his book '*Corporate power and responsibility*', he studies the impact of different corporate theories for company laws and in particular analyses the effectiveness of directors' duties as they were in the 1990s. He includes the concept of Corporate Social Responsibility in his work and therefore makes some link between corporate governance debates (in particular directors' duties), the impact of business on society and the concept of CSR. See J E Parkinson, *Corporate Power and Responsibility* (OUP 1993) vii – viii.

<sup>270</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-40.

<sup>271</sup> Roach is one of the few scholars to address CSR in the debate about the reform of English company law. In his brief discussion of the concept he argues that CSR 'has been used interchangeably with stakeholder theory'. Equating it with non-shareholder constituents, he distinguishes between 'internal corporate social responsibility' and 'external social responsibility'. For him these terms run parallel to the division of stakeholders into internal stakeholders (e.g. employees, creditors) and external stakeholders (e.g. the environment and the local community). L Roach, 'The paradox of the traditional justifications for exclusive shareholder governance protection: expanding the pluralist approach' (2001) 22 *Company Lawyer* 9, 13.

<sup>272</sup> See for the relationship between corporate theory and CSR: J Parkinson, *Corporate Power and Responsibility* (OUP 1993) vii – viii. See for a discussion about corporate theory: D Millon, 'Theories of the corporation' (1990) *Duke Law Journal* 201.



company law. The debates about corporate theory in the review process leading to the Companies Act 2006 therefore, by and large, did not include CSR.<sup>273</sup>

Despite some recent research, CSR is still far from being a mainstream issue in company law and corporate governance. This situation becomes obvious when one looks at the contents of the leading English company law textbooks. In fact, these books do not yet substantially, if at all, address CSR. The question of whether CSR is included in company law textbooks is a useful indicator of how far CSR is considered to be part of company law. Some books have started to engage with CSR in their latest editions, albeit briefly by devoting only one paragraph on CSR.<sup>274</sup> For instance, Mayson, French & Ryan have one subchapter about 'The company's position in society' which briefly outlines the hitherto narrow concept of company law in English law with its focus on the interest of the shareholders and their relationship with directors.<sup>275</sup> The authors of this book argue that it was never felt necessary to regulate CSR through company law as all firms would have an impact on their constituents (no matter if they are a corporation or not) and that there was therefore no need to specifically regulate this relationship in company law. It would rather be a matter of specific fields that affect all firms such as employment law. Other textbooks do not directly address CSR, although there is discussion of how corporate governance systems allow or limit the engagement of firms with the interests other than those of the shareholders.<sup>276</sup> These findings are also reflected in the indices of these books, as CSR is not included. These observations indicate that the company law and corporate governance literature has not yet sufficiently explored CSR, although links between these do exist.<sup>277</sup>

The outline of the regulatory framework of CSR above has, inter alia, shown that the duty to promote the success of the company in s172 (1) Companies Act 2006 as well as the business review in s417 of the Companies Act 2006 have relevance for CSR. The enlightened shareholder value theory, which underlies the Companies Act 2006, enables, at least in theory, companies to pursue CSR goals. The question to what extent companies can promote CSR within this framework has been not sufficiently analysed in the literature so far. Comparable to the debates revolving

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<sup>273</sup> The relationship between corporate theory, company law/corporate governance and CSR will be discussed in chapter 3 of this thesis.

<sup>274</sup> See B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-40; D French, S Mayson and C Ryan, *Mayson, French and Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-12) para 1.6.4.1.

<sup>275</sup> D French, S Mayson and C Ryan, *Mayson, French and Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-12) para 1.6.4.1.

<sup>276</sup> J Birds et al. (eds), *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 11.6; P Davies and S Worthington, *Gower and Davies' Principles of Modern Company Law* (9<sup>th</sup> edn, Sweet & Maxwell 2012).

<sup>277</sup> See J Parkinson, *Corporate Power and Responsibility*, (OUP 1993), vii – viii; A Adeyeye, 'The limitations of corporate governance in the CSR agenda' (2010) 31 *Company Lawyer* 114.

around the reform of English company law in the run-up to the Companies Act 2006, analyses of the new s172 CA 2006 duty often do not even mention CSR at all.<sup>278</sup> Instead, the meaning of enlightened shareholder value and its implications for stakeholder interests is discussed.<sup>279</sup> There is potential for the literature to more deeply analyse the ability of the s172 CA duty to promote the interest of the company for CSR, particularly as it has been noted that CSR was implicit in s172 CA.<sup>280</sup> It is therefore characteristic that a recent comparison of the economic and social responsibilities of directors calls CSR ‘the future’, but does not fully explore the extent to which directors have to comply with CSR requirements.<sup>281</sup>

Although CSR is not (yet) sufficiently on the company law and corporate governance agenda, there are signs in the recent literature that this situation is about to change. The interest of company lawyers in CSR seems to have increased in the aftermath of the global financial and economic crisis, however.<sup>282</sup> In his discussion of corporate governance<sup>283</sup> and CSR, Adeyeye acknowledges the limited role which corporate governance has so far played for CSR issues.<sup>284</sup> Mitchell, too, emphasises the potential importance of corporate governance by arguing that CSR would need to be moved into the scope of corporate governance in order to have any legal impact.<sup>285</sup> He notes that the CSR debate per se has achieved little change whereas corporate governance would repay scholarly attention with its impact on company law and in particular on corporate fiduciary duties.<sup>286</sup> Focussing on the board would be the best method of achieving good results.<sup>287</sup> Some scholars have made concrete suggestions for the way forward for CSR in company law and corporate governance. Villiers, for example, discusses legal strategies that would support the socially responsible conduct of companies such as legislation to remove the corporate veil in

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<sup>278</sup> See only A Alcock, “An accidental change to directors’ duties” (2009) 30 *Company Lawyer* 362.

<sup>279</sup> *ibid.*

<sup>280</sup> J L Yap, ‘Considering the enlightened shareholder value principle’ (2010) 31 *Company Lawyer* 35, 37.

<sup>281</sup> B Perry and L Gregory, ‘The European panorama: directors’ economic and social responsibilities’ (2009) 20 *ICCLR* 25, 36.

<sup>282</sup> Examples of articles published after the financial and economic crisis are: C Pedamon, ‘Corporate social responsibility: a new approach to promoting integrity and responsibility’ (2010) 31 *Company Lawyer* 172; J Zhao and J Tribe, ‘Corporate social responsibility in an insolvent environment: directors’ continuing obligations in English law’ (2010) 21 *ICCLR* 305; J Yap, ‘Considering the enlightened shareholder value’ (2010) 31 *Company Lawyer* 35; A Adeyeye, ‘The limitations of corporate governance in the CSR agenda’ (2010) 31 *Company Lawyer* 114; C Nakajima, ‘The importance of legally embedding corporate social responsibility’ (2011) 32 *Company Lawyer* 257.

<sup>283</sup> As indicated, the terms ‘corporate governance’ and ‘company law’ will be differentiated in chapter 3.

<sup>284</sup> A Adeyeye, ‘The limitations of corporate governance in the CSR agenda’ (2010) 31 *Company Lawyer* 114.

<sup>285</sup> L Mitchell, ‘The board as a path towards corporate social responsibility’ in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 280.

<sup>286</sup> *ibid.*

<sup>287</sup> *Ibid.*

case of involuntary tort creditors of corporate groups.<sup>288</sup> Several contributions to the recent book 'The New Corporate Accountability' specifically focus on what company law can do to promote CSR such as making disclosure laws compulsory.<sup>289</sup> Such ideas provide a good starting point for future work on how to incorporate CSR into law. They indicate that company law and corporate governance have potential to include CSR into its scope and to regulate CSR concerns. It therefore seems that there is a developing literature in company law and corporate governance that engages with CSR. Yet, there is scope for more in-depth analysis of the relationship between corporate theory, corporate governance and CSR as well as the ability of the Companies Act 2006 to promote the socially responsible conduct of companies (e.g. through the duty in s172 CA or the business review in s417 CA).

Tort law, on the other hand, has more readily engaged with CSR, particularly concerning tortious liability of companies for human rights violations.<sup>290</sup> The focus of this literature has, so far, primarily been on the extraterritorial application of tort law to torts committed overseas, either directly by English multinational companies or by their subsidiaries.<sup>291</sup> The problem in countries of the developing world is usually not so much the letter of the law (which often provides causes of action in tort, for example, in case of human rights violations), but the restricted access to justice and the enforcement of the local laws.<sup>292</sup> The literature on CSR and tort law has therefore looked with interest at the example of the US Alien Tort Claims Act (ATCA) through which parent companies based in the USA can be held accountable for human rights violations by their subsidiaries abroad.<sup>293</sup> The ATCA confers jurisdiction on the US District Courts in respect of 'any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'.<sup>294</sup> The Act has been regarded to fill an accountability vacuum resulting from the non-existence of international regulation and the territorial reach of domestic

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<sup>288</sup> C Villiers, 'Corporate law, corporate power and corporate social responsibility' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 107.

<sup>289</sup> K Campbell and D Vick, 'Disclosure Law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 278.

<sup>290</sup> See M Anderson, 'Transnational Corporations and Environmental Damage: Is Tort Law the Answer?' (2002) 41 *Washburn Law Journal* 399; P Muchlinski, 'Holding multinationals to account: recent developments in English litigation and the Company Law Review' (2002) 23 *Company Lawyer* 168.

<sup>291</sup> See S Baughen, 'Multinationals and the Export of Hazard' (1995) 58 *Modern Law Review* 54; P Muchlinski, 'Corporations in international litigation: problems of jurisdiction and the United Kingdom asbestos case' (2001) 50 *ICCLR* 1.

<sup>292</sup> P Nygh, 'The liability of multi-national corporations for the torts of their subsidiaries' (2002) 3 *EBOLR* 51, 80.

<sup>293</sup> D McBarnet and P Schmidt, 'Corporate accountability through creative enforcement: human rights, the Alien Torts Claims Act and the limits of legal impunity' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 148.

<sup>294</sup> 28 USC §1350.

laws.<sup>295</sup> Whilst the ACTA is an interesting approach to the extraterritorial liability of multinational enterprises in the area of extraterritorial application of tort law, it would go beyond the scope of this thesis to substantially engage with the question to what extent it could be a model for English law. The extraterritorial application of tort law is primarily a matter of private international law. It is rather necessary, first of all, to substantially analyse the question to what extent *current* English tort law provides causes of action for corporate conduct that violates CSR principles. Such a doctrinal analysis provides a basis for discussions about the ways in which English tort law already promotes or could better promote CSR. Moreover, the overlap between company law and tort law is relevant in this regard, as many violations of CSR principles are committed by the subsidiaries of multinational companies. The situation that parent companies often avoid liability in tort for the conduct of their subsidiaries due to the use of corporate group structures and the separate legal personality doctrine is already addressed in the literature.<sup>296</sup> However, this issue has become topical again due to the recent decision in *Chandler v Cape Industries plc* where the parent company was held to owe a direct duty of care in negligence to the employee of one of its subsidiaries.<sup>297</sup> It is therefore necessary in this thesis to examine the question to what extent this case sets a precedent for the future liability of parent companies in tort to the employees of their subsidiaries.

Finally, the trend highlighted in the previous section that companies increasingly adopt CSR commitments through corporate codes of conduct and that companies also increasingly incorporate these CSR commitments into their contracts with their

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<sup>295</sup> S Colliver et al., 'Holding Human Rights Violators Accountable by Using International Law in US Courts: Advocacy Efforts and Complementary Strategies' (2005) 19 *Emory International Law Review* 169. The landmark case of *Filartiga v. Pena-Irala* (630 F 2d 876 ((2d Cir. 1980)) in 1980 drew attention to the potential of the ATCA as a means of holding individuals accountable for breaches of human rights standards in other countries. In this case, the court decided that non-American citizens could be punished for tortious acts committed outside the United States which were in violation of public international law (the law of nations) or any treaties to which the United States is a party. The decision therefore extends the jurisdiction of United States courts to tortious acts committed around the world. In *Sosa v Alvarez* (542 US 692 (2004)), the US Supreme Court allowed courts to hear claims by private individuals for breaches of international law committed in other countries. The number of proceedings under this Act against US parent companies has significantly increased in the past years. The fact that lawsuits are privately initiated has added to its popularity as the proceedings are not reliant on the state. There are limitations to the ATCA such as that the courts are reluctant to assume jurisdiction in cases where the claimants are not resident in the United States. Notably, the future of the Act for holding corporations accountable for human right violations is uncertain, following the decision of the Supreme Court in *Kiobel v Royal Dutch Petroleum Co.* 569 U.S.\_\_\_\_ (2013), decided 17<sup>th</sup> April 2013. In that case, the Supreme Court held that the Act would only apply to conduct within the United States or on the high seas. The court held that the presumption against extraterritoriality would apply to claims under the Act and that nothing in the Act would rebut that presumption. Prior to these decisions, there has been a lot of lobbying by US corporations to the government to restrict the applicability of the ATCA. After the Supreme Court decision from April 2013 it is unlikely that the ATCA will be used largely in the future for claims against corporations based on human rights abuses committed abroad.

<sup>296</sup> P Muchlinski, 'Holding multinationals to account: recent developments in English litigation and the Company Law Review' (2002) 23 *Company Lawyer* 268.

<sup>297</sup> [2012] EWCA Civ 525 which affirms [2011] EWHC 951 (QB).

suppliers has so far been extensively discussed in the management literature.<sup>298</sup> In contrast, given the potential for CSR to be promoted through law, the legal literature has not yet sufficiently engaged with these developments apart from some introductory overviews.<sup>299</sup> There are no substantial analyses of the ways in which English contract law promotes the incorporation and the enforcement of CSR commitments in supply contracts. Similarly, there is no detailed analysis of the question of whether English consumer law protects consumers against statements by companies that they would comply with specific CSR obligations that they have undertaken where, in fact, they violate these principles. Both these areas will be discussed in the subsequent analysis.

## 2.5 Conclusion

The discussion of the regulatory framework for CSR has revealed that CSR and law overlap, or at least have the potential to overlap, in a number of ways. This overview supports the view taken here that CSR is, at least in part, law. The implications of this view will be discussed in detail in the subsequent substantive chapters. As a preliminary conclusion, we see that, on the whole, the regulatory framework of CSR indicates that English private law already plays an important role for the promotion of CSR. Apart from direct overlaps between CSR and company law and tort law, private law also provides tools for the incorporation of CSR commitments into contracts and for its enforcement by consumers.

The literature review has shown that, so far, the academic discussion about CSR and the law has not yet fully recognised the contribution that English private law makes to the promotion of CSR, as indicated in the regulatory framework. Traditionally, academic debates were confined to binary debates ('either...or') about the question whether or not CSR should be regulated in law. These debates are not only a superficial view of the ways in which law functions, but they have also

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<sup>298</sup> See for example J Leigh and S Waddock, 'The Emergence of Total Responsibility Management Systems: J. Sainsbury's (plc) Voluntary Responsibility Management Systems for Global Food Retail Supply Chains (2006) 111 (4) *Business and Society Review* 409 – 426; B Jiang, 'Implementing Supplier Codes of Conduct in Global Supply Chains: Process Explanations from Theoretic and Empirical Perspectives' (2009) 85 *Journal of Business Ethics* 77 – 92; C Valor, 'Can Consumers Buy Responsibly? Analysis and Solutions for Market Failures' (2008) 31 *Journal of Consumer Policy* 315; J Singh, O Iglesias and J Batista-Foguet, 'Does Having an Ethical Brand Matter? The Influence of Consumer Perceived Ethicality on Trust, Affect and Loyalty' *Journal of Business Ethics*, published online: 31 January 2012; G Eckhardt, R Belk and T Devinney, 'Why don't consumers consume ethically?' (2010) 9 *Journal of Consumer Behaviour* 426;

<sup>299</sup> For an introduction into supply chain contracts see: D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and 'other-regulation' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 59. Consumer law is touched on in the following chapter: C Glinski, 'Corporate codes of conduct: moral or legal obligation?' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 119.

prevented the further understanding of the effects of the legal framework of CSR. Whilst this debate now moves on, partly due to a realisation that there are overlaps between law and CSR, the existing literature is predominately written from an international law perspective. The importance of private law for CSR shown in the regulatory framework reveals the need for a detailed analysis of the promotion of CSR in English private law. This is the main research agenda of this thesis. The thesis will add to existing emergent analyses of the contributions of company law and corporate governance as well as tort law to the promotion of CSR. It will develop original substantial analysis on the question if and, if so, how English contract law and English consumer law promote CSR. To that end, the doctrinal perspective taken in this thesis will complement socio-legal approaches to the regulatory CSR framework already found in the literature.

# Chapter 3: English company law, corporate governance and CSR

## 3.1 Introduction

English company law and corporate governance have in recent years been subject to substantial changes through the enactment of the Companies Act (CA)<sup>300</sup> 2006. The global financial and economic crisis caused several reviews of the system of corporate governance in English and European Union company law.<sup>301</sup> A particular feature of the Companies Act 2006 is its endorsement of the enlightened shareholder value theory.<sup>302</sup> This change was intended to promote a long-term approach to doing business, which includes a range of stakeholders, rather than purely focusing on shareholders.<sup>303</sup> This aim of the enlightened shareholder value approach overlaps with the concept of Corporate Social Responsibility (CSR), as CSR implies an obligation on the part of large companies to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders but also stakeholders such as employees, consumers, suppliers, creditors and local communities.<sup>304</sup> As already noted in chapter 2, it has therefore been argued that the revised Companies Act has several potential CSR implications.<sup>305</sup> This potential link is important for this thesis as it raises the question to what extent English company law and corporate governance promote the socially responsible conduct of companies.<sup>306</sup> This question will be analysed in this chapter. The chapter will also make suggestions about how English company law and corporate governance could be further developed to better promote CSR.

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<sup>300</sup> In the following, unless indicated differently, the abbreviation 'CA' will refer to the Companies Act 2006.

<sup>301</sup> See Walker, *A review of corporate governance in UK banks and other financial industry entities, Final recommendations* (November 2009); European Commission, 'Corporate governance in financial institutions and remuneration policies' COM (2010) 284; BIS Department for Business, Innovation & Skills, *A long term focus for Corporate Britain: Summary of Responses* (2011); EU Commission, 'The EU corporate governance framework' COM (2011) 164 final.

<sup>302</sup> See for example: A Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 23 *Sydney Law Review* 23.

<sup>303</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 229.

<sup>304</sup> K Campbell and D Vick, 'Disclosure law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 242.

<sup>305</sup> *ibid.*, 229.

<sup>306</sup> It is important to note that the Companies Act applies to the whole of the United Kingdom and not just to England and Wales. However, for reasons of consistency in this thesis which focusses on English private law, this chapter will refer to English company law. See s1299 CA2006: 'Except as otherwise provided (or the context otherwise requires), the provisions of this Act extend to the whole of the United Kingdom.'

This chapter will focus on both company law and corporate governance as these are related, but different concepts. The scope of corporate governance is wider.<sup>307</sup> For analytical clarity, the chapter will first establish the relationship between company law, corporate governance and CSR. The discussion about the link between the three particularly focusses on the adoption of the enlightened shareholder value theory as the approach underlying the Companies Act 2006. The theoretical framework of the enlightened shareholder value approach characterises the system of company law and corporate governance in English law and will therefore be looked at first in terms of its implications for CSR.<sup>308</sup> This part will be followed by an analysis of the promotion of CSR by different aspects of corporate governance. The aspects which are discussed in this chapter are the newly codified director's duty in s172 CA to promote the success of the company, the duty for directors to file a business review pursuant to s417 (2) CA, the role of shareholders, particularly with regard to the new statutory derivative action in s260 CA, and finally the role of non-executive directors as well as the composition of the board.

The potential significance of company law and corporate governance for CSR was also emphasised in the 2011 final report of the UN Special Representative on the issue of human rights and business (SRSG) John Ruggie.<sup>309</sup> Principle 3 of the UN Guiding Principles on Business and Human Rights recommends that states should, inter alia, ensure that company law does not constrain, but enables respect for human rights.<sup>310</sup> The commentary to this principle makes the criticism that there is 'a lack of clarity in corporate and securities law regarding what companies and their officers are permitted, let alone required, to do regarding human rights'.<sup>311</sup> Moreover, the implications of corporate and securities laws for human rights 'remain poorly

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<sup>307</sup> Du Plessis notes that the meaning of corporate governance has 'surprisingly not been the topic of many in-depth studies in the past', see: J Du Plessis, 'Corporate law and corporate governance lessons from the past: ebbs and flows, but far from "the end of history...": Part 1' (2009) *Company Lawyer* 43. The following are considered to be sources of company law: Primary legislation (Companies Act 2006), secondary legislation, rule-making by legislatively created bodies, for instance, the UK Corporate Governance Code, the common law of companies and the company's own constitution. The sources of corporate governance overlap with these, but are more diverse. They also encompass codes, reports and statements of good corporate governance codes prepared inter alia by industry groups or individual institutional investors.

<sup>308</sup> See K J Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) European Corporate Governance Institute, Law Working Paper 170/2011, 6, available at: [http://ssrn.com/abstract\\_id=1713750](http://ssrn.com/abstract_id=1713750) (last accessed 3/4/2012).

<sup>309</sup> <http://www.business-humanrights.org/media/documents/ruggie-statement-to-un-human-rights-council-30-may-2011.pdf> (last accessed 04/01/2012).

<sup>310</sup> Principle 3, UN Guiding Principles on Business and Human Rights.

<sup>311</sup> John Ruggie, *Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework*, available at: <http://www.business-humanrights.org/SpecialRepPortal/Home/Protect-Respect-Remedy-Framework/GuidingPrinciples> (last accessed 04/01/2012). The comments made by Ruggie refer to company law generally and are not related to a specific national company law.



understood'.<sup>312</sup> As human rights are an important element of the CSR agenda, this principle shows the potential importance of company law and corporate governance for the promotion of CSR. The criticisms made in the commentary to principle 3 of the UN Guiding Principles correspond to the literature reviewed in the previous chapter, which demonstrated that company law and corporate governance, as understood in English law, has long considered stakeholder-oriented issues, including CSR, to be outside its realm.<sup>313</sup>

### 3.2 Jurisdictional scope of the chapter

As issues of CSR frequently refer to the conduct of multinational enterprises both in England and Wales as well as abroad, it is necessary to establish when English courts have jurisdiction to hear a dispute and when English law is applicable in matters of company law and corporate governance.<sup>314</sup>

In civil and commercial matters English courts must apply the Brussels I Regulation in order to determine if they can assume jurisdiction.<sup>315</sup> Article 2 of the Regulation stipulates that persons should be sued where they are domiciled.<sup>316</sup> The definition of 'domicile' for individuals is determined by national private international laws.<sup>317</sup> Pursuant to Article 60 (1) of the Regulation, a company is domiciled at the place

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<sup>312</sup> *ibid.*

<sup>313</sup> See chapter 2 of this thesis. See also: A Adeyeye, 'The limitations of corporate governance in the CSR agenda' (2010) *Company Lawyer* 114.

<sup>314</sup> As the rules of private international law pertaining to companies differ between states, it is beyond the scope of this thesis to address this issue from the perspective of different states. The focus here is on the question whether or not English courts have jurisdiction over company law disputes involving companies which are incorporated in England or Wales or which were incorporated abroad. Due to the focus of the thesis on English private law, the discussion of the jurisdictional scope of the different substantive chapters will also focus on England and Wales and not discuss to what extent these areas of private law are also applicable to Scotland and/or Northern Ireland.

<sup>315</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters" (or Council Regulation (EC) 44/2001), known as 'Brussels I'.

<sup>316</sup> This Regulation is directly applicable to all EU member states. It determines jurisdiction in civil and commercial matters where the defendant is domiciled in a member state of the EU. The Regulation is concerned with the international jurisdiction of member states. Distinct from this situation is the scenario of parent companies domiciled in England or Wales and their subsidiaries domiciled abroad which will be addressed in chapter 6. English law treats parent companies as independent from their subsidiaries, see *Adams v Cape Industries* [1990] 1 Ch 433.

<sup>317</sup> See J Fawcett and J Carruthers, *Cheshire, North & Fawcett: Private International Law* (14<sup>th</sup> edn, OUP 2008) 211. As the concept of seat is established according to each member states' own private international law, conflicts of jurisdiction can still arise. This is particularly the case as there are two different traditions in the treatment of companies in private international law: the incorporation theory, followed by most common law jurisdictions including England, and the real seat doctrine, followed by many continental European jurisdictions such as Germany and France. According to the real seat doctrine, the governing law of a corporation is the law of the place where the real seat of management is placed. With regard to the European Union, the ECJ held in its trilogy of cases in *Centros* (Case C212/97, [2000] Ch 446), *Überseering* (Case C208/00, [2005] 1 WLR 315) and *Inspire Art* (C167/01, [2003] that it is compatible with the freedom of establishment in the EU that a company can be incorporated in one Member State and then solely trade in another Member State. See for an overview of this topic: D Milman, *National Corporate Law in a Globalised Market: The UK Experience in Perspective* (Edward Elgar 2009) 120 – 129.

where it has its: (a) statutory seat, or (b) central administration, or (c) principal place of business. Art 60 (2) further states that 'For the purposes of the United Kingdom and Ireland "statutory seat" means the registered office or, where there is no such office anywhere, the place of incorporation or, where there is no such place anywhere, the place under the law of which the formation took place.'<sup>318</sup> English private international law follows the incorporation doctrine which stipulates that the place of incorporation determines the domicile.<sup>319</sup> The incorporation doctrine is therefore important in the situation where an English court determines whether it has jurisdiction pursuant to Art 60 (2) of the Regulation.

Moreover, the incorporation doctrine also determines the law governing the corporation.<sup>320</sup> The matters addressed in this chapter, such as directors' duties or shareholders' rights, are thus governed by the place of incorporation as far as English courts are concerned.<sup>321</sup> The Companies Act 2006 is therefore applicable in relation to companies incorporated in England or Wales, even if they have no significant premises or activities in England or Wales and conduct their activities abroad.<sup>322</sup>

### **3.3 Background: The discussion about the corporate purpose and CSR**

#### **3.3.1 Linking the concepts of CSR and corporate governance**

We have already noted that corporate governance and CSR are related. But what is their relationship? Corporate governance is commonly understood as 'the set of processes, customs, policies, laws and institutions affecting the way a company is

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<sup>318</sup> Moreover, Article 22 (2) of the Regulation confers exclusive jurisdiction to the courts of the company's seat in matters concerning the internal affairs of companies: 'in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons, or of the validity of the decisions of their organs, the courts of the Member State in which the company, legal person or association has its seat. In order to determine that seat, the court shall apply its rules of private international law.'

<sup>319</sup> Lord Collins of Mapesbury, C G J Morse, D McClean et al. (eds), *Dicey, Morris & Collins on the Conflict of Laws* (154<sup>th</sup> edn, Vol. 2, Sweet & Maxwell 2012) Rule 30, para 11-093.

<sup>320</sup> *ibid*, Rule 160: 'The domicile of a corporation is in the country under whose law it is incorporated'.

<sup>321</sup> *ibid*, Rule 162, paras 30R-020–30-024: The place of incorporation determines the composition and power of the various organs of the corporation which, *inter alia*, encompasses the following issues: The appointment of directors, the nature and extent of the duties owed by the directors to the corporation. The authors also argue that it seems that the right of a shareholder to bring a derivative action in respect of wrongs done to a corporation is, in a case containing a foreign element, a matter of substance not procedure and is governed, accordingly, by the place of incorporation. The question of the applicable law in case of a legal dispute about directors' duties was addressed in *Base Metal Trading Ltd v Shamurin* [2005] 1 WLR 1157. This case concerned a company which was incorporated in Guernsey, but carried out business in Russia. The Court of Appeal held that the law of Guernsey was the applicable law in terms of the duties of the directors of this company: 'The only system of law that can consistently and effectively regulate such multinational companies is the law of the place of incorporation', at para 75.

<sup>322</sup> *ibid*, Rule 162, para 30-032.

directed, administered or controlled'.<sup>323</sup> This is a short version of the definition of corporate governance, promulgated by the Cadbury Committee which is regarded as the 'the most authoritative definition of corporate governance in the UK'.<sup>324</sup> With regard to its scope, corporate governance focuses on the ownership, direction and control of companies.<sup>325</sup> According to the definition of CSR used for this thesis, CSR is about wider relationships with various stakeholders, not just shareholders.<sup>326</sup> CSR requires companies to advance the interests of the different stakeholders, for example the employees and the local community. These interests are not purely economic.

Horrigan makes an important point about how one's approach to corporate governance defines the relation between corporate governance and CSR

The variety of standpoints from which we might conceive the point of corporate governance from the outset inevitably affects the approach we take to define what corporate governance means. In turn, this affects how we characterise the relation (if any) between corporate governance and CSR.<sup>327</sup>

This observation is a significant one, as it highlights that there is interdependence between corporate theory, corporate governance and CSR. Corporate theory is the theoretical framework underlying the system of company law and corporate

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<sup>323</sup> R Smerdon, *A practical guide to Corporate Governance* (4<sup>th</sup> edn, Sweet & Maxwell 2007) 1. The classic and most-widely used definition of corporate governance is the one by the Cadbury Committee (1992): 'Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meetings.'

The UK Corporate Governance Code which applies to premium listed companies and which was issued by the Federal Reporting Council (FRC) in June 2010 and provides principles of corporate governance. It is a statement of best practice. Every company with premium listed shares is subject to listing rules which require an annual statement of whether or not the company has complied with the principles throughout the accounting period on which it reports. The company must explain if it has not complied with the Code. This is known as the 'comply or explain' approach.'

<sup>324</sup> J Birds et al. (eds) *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 11.3. The UK Corporate Governance Code also refers to this definition.

<sup>325</sup> K J Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) European Corporate Governance Institute, Law Working Paper 170/2011, 6, available at: [http://ssrn.com/abstract\\_id=1713750](http://ssrn.com/abstract_id=1713750) (last accessed 3/4/2012) Hannigan therefore addresses the following topics in her book on Company Law under the heading 'Corporate governance': Directors' duties, shareholders' rights and remedies as well as the composition of the board, see B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP, Oxford 2012).

<sup>326</sup> Campbell and Vick define CSR in the following way: 'At a minimum the term implies an obligation on the part of large companies to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders, but also employees, consumers, suppliers, creditors and local communities. These interests are not just economic, but also include environmental, human rights and 'quality of life' concerns. The obligation to be socially responsible is usually conceived of as being over and above the minimum requirement imposed on companies by formal legal rules, although this is not invariably the case.' K Campbell and D Vick, 'Disclosure Law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 242.

<sup>327</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 175.

governance.<sup>328</sup> It is important for the relationship between corporate governance and CSR as it, in Horrigan's words, describes 'the standpoint from which we conceive the point of corporate governance'.<sup>329</sup> Millon notes that 'corporate theory can be used to legitimate or criticise corporate doctrine'.<sup>330</sup> However, he also points out that the actual extent to which 'normative claims...are perceived to follow in a determinate way from the underlying positive assertion is controversial'.<sup>331</sup> Corporate theory deals with the question in whose interest corporations are run. It thus determines what the purpose of the company is. The purpose of the company has an effect on the scope of corporate governance, including directors' duties.<sup>332</sup> The underlying corporate theory therefore has an impact on the question whether a company may pursue social and environmental goals.

The underlying corporate theory therefore at least influences the ability of the system of corporate governance to promote CSR. The theoretical model of the company and CSR can positively correlate with each other or be in conflict with each other depending on the respective position of shareholders and non-shareholders in the model. If the corporate theory focusses on the (short-term) interests of shareholders, then it does not have a positive impact on CSR.<sup>333</sup> However, if the promotion of stakeholders' interests is within the scope of the theoretical framework (e.g. in a pluralist model of the company), then corporate governance can better promote CSR.<sup>334</sup>

Against this theoretical background, corporate governance and CSR meet at various points that will be addressed in this chapter. The first point is directors' duties. The reason for this link is that directors' duties are part of corporate governance and the ways in which directors (may) discharge their duties are one factor that determines to what extent a company pursues CSR objectives. The newly introduced directors' duty in s172 CA, to promote the success of the company for the benefit of its members as a whole, raises the question to what extent the discharge of this duty requires the directors to promote the interests of its various stakeholders and hence CSR goals. CSR and corporate governance are linked where a company

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<sup>328</sup> See for a discussion of the significance of corporate theory: D Millon, 'Theories of the corporation' (1990) *Duke Law Journal* 201, 241.

<sup>329</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 175.

<sup>330</sup> D Millon, 'Theories of the corporation' (1990) *Duke Law Journal* 201, 241.

<sup>331</sup> *ibid*, 241, 243-251.

<sup>332</sup> A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 14.

<sup>333</sup> However, CSR can be pursued to promote the reputation and, consequently, the sales of a company (often referred to as 'the business case for CSR').

<sup>334</sup> C Nakajima, 'The importance of legally embedding corporate social responsibility' (2011) *Company Lawyer* 257, 258.

internalises its social and environmental impact.<sup>335</sup> As outlined in the previous paragraph, the extent to which directors are allowed to internalise the company's social and environmental impact through s172 CA is influenced by the theoretical framework underlying the system of corporate governance (corporate theory), i.e. the enlightened shareholder value approach which is discussed below.

The second point where corporate governance and CSR meet is the business review that directors have to complete pursuant to s417 CA.<sup>336</sup> The purpose of the business review is to inform members about the ways in which directors have discharged their duty under s172 (1) CA.<sup>337</sup> Thirdly, corporate governance and CSR are also linked through shareholders' remedies. For example, through the derivative action pursuant to s260 CA, under certain circumstances shareholders have the right to start proceedings on behalf of the company, if directors are alleged to have breached their duties. This action includes remedies for breaches of the duty in s172 CA, which, as we have just noted, overlaps with CSR. Shareholders could therefore bring a derivative action in case of an alleged breach of s172 CA.<sup>338</sup> Finally, the board can more generally be an important factor for the promotion of CSR, particularly through non-executive directors as well as the composition of the boardroom.

Despite these potential overlaps between corporate governance and CSR, the link between the two concepts has, so far, not been widely explored in the academic literature. Horrigan therefore notes that the connection between the two 'does not meet with universal acclaim'.<sup>339</sup> Yet, these two concepts are not 'mutually exclusive'.<sup>340</sup> The various points where CSR and corporate governance meet, for example the duty to promote the success of the company in s172 CA, demonstrate that corporate governance can be an important tool in the promotion of CSR. The CSR agenda should therefore include corporate governance within its focus. Mitchell even argues that 'the most likely way for proponents of CSR to achieve their goals is to recast their issues as issues of corporate governance'.<sup>341</sup>

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<sup>335</sup> J Dine, *Companies, International Trade and Human Rights* (CUP 2005) 223.

<sup>336</sup> The proposed changes to narrative reporting in the Companies Act will be discussed below.

<sup>337</sup> S417 (2) CA.

<sup>338</sup> However, it will be shown later that, in fact, that is unlikely to be successful as the courts are unwilling to interfere with business decisions of the directors.

<sup>339</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 174.

<sup>340</sup> C Nakajima, 'The importance of legally embedding corporate social responsibility' (2011) *Company Lawyer* 257, 258.

<sup>341</sup> L E Mitchell, 'The board as a path toward corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 280.

The following section will briefly review the three theories about the objective of the company that have dominated the discussions in the preparation of the Companies Act 2006, namely the shareholder value theory, the stakeholder value theory and the enlightened shareholder value theory.<sup>342</sup> The enlightened shareholder value theory underlies the Companies Act 2006. It is not possible, within the scope of this chapter, to comprehensively address all justifications for and arguments about the respective theories; rather it is intended to introduce these theories as background to the subsequent analysis of the promotion of CSR in English company law and corporate governance.<sup>343</sup>

### **3.3.2 The background to the adoption of the enlightened shareholder value theory**

#### **3.3.2.1 The shareholder value theory**

There was a considerable debate about corporate theory in the Company Law Review Steering Group<sup>344</sup> during the discussions about the new Companies Act 2006, as the hitherto prevailing shareholder value doctrine had come under criticism in English law.<sup>345</sup> The Company Law Review Steering Group contrasted the shareholder value theory (also referred to as the Anglo-American model) with the pluralist approach (also referred to as the stakeholder value model, represented, for instance, by Germany and Japan)<sup>346</sup> and a third model, the so-called 'inclusive approach' (also referred to as the enlightened shareholder value theory), which it finally adopted in its White Paper.<sup>347</sup>

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<sup>342</sup> The 'stakeholder value theory' was referred to as the 'pluralist model' in the review process of English company law that led to the Companies Act 2006. Johnston suggests classifying the two main economic theories that have dominated the long-running shareholder versus stakeholder debate under the headings of the agency model and the productive coalition model, see: A Johnston, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) *EBOLR* 817, 821.

<sup>343</sup> It is also not possible to engage with others models of the company that were suggested in the literature, such as the 'Entity Maximisation and Sustainability Model', proposed by Keay. See: A Keay, *The Corporate Objective* (Edward Elgar 2011).

<sup>344</sup> In 1998 the Department of Trade and Industry launched a process of reviewing the Companies Act 1985 with the aim of reforming it. The Company Law Review was made up of a Steering Group, essentially consisting of lawyers and businessmen, and several working groups. See for an overview of the company law review process: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 65 – 84.

<sup>345</sup> A Johnston, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) *EBOLR* 817; J W Salacuse, 'Corporate governance in the new century' (2004) 25 *Company Lawyer* 69, 71. The Company Law Review Steering Group acknowledged that the shareholder value model had been in operation in English company law, see: Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) paras 5.1.4 – 5.1.7.

<sup>346</sup> S Wen, 'The magnitude of shareholder value as the overriding objective in the UK: the post-crisis perspective' (2011) *Journal of International Banking Law and Regulation* 325, 326; A de Jonge, *Transnational Corporations and International Law* (Edward Elgar 2011) 8 – 9.

<sup>347</sup> For reasons of consistency, the 'pluralist approach' will be referred to as the 'stakeholder value theory' and the 'inclusive approach' as the 'enlightened shareholder value theory' in this thesis.

The shareholder value doctrine is based on an agency model which has strongly influenced debates about corporate governance in the United States and the United Kingdom.<sup>348</sup> The basis for this agency model lies in Berle and Means' observation known as 'separation of ownership and control'.<sup>349</sup> They identified the situation that the ownership of the company and its control had become divided between the shareholders of the company and its management whereas, originally, it was united in the person of the entrepreneur.<sup>350</sup> As the group of shareholders had increasingly become diverse and geographically dispersed, it experienced difficulty in the exercise of control over the management. In practice, it was often the managers who had gained effective control over the company (the situation is also referred to as 'managerialism'). The identification of this phenomenon initiated the corporate governance debate. The agency theory argues that the directors are the agents of the shareholders.<sup>351</sup> Consequently, the management should be exclusively accountable to the shareholders (who are their principals) and primarily strive to maximise their profit.<sup>352</sup> It has been argued that the preoccupation of this model with shareholders' rights would benefit the company (and society) as it ensures accountability and therefore reduces the likelihood that the board could act in a self-serving way.<sup>353</sup>

Under this model the company is treated as a nexus of contracts, which means that the corporate entity is regarded as a 'legal fiction' created out of explicit and implicit private contracts.<sup>354</sup> According to this theory, the shareholders are the company's residual claimants as the other corporate constituencies have fixed claims, for example employment contracts. The shareholders are the only constituents whose interest (i.e. dividend) is not secured, for example by an explicit contract such as a loan agreement. For this reason they only receive what is left over (the so-called 'residual earnings') after the company has fulfilled all its other contractual

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<sup>348</sup> A Johnston, *EC Regulation of Corporate Governance* (CUP 2009) 21.

<sup>349</sup> A Berle and G Means, *The Modern Corporation and Private Property* (Transaction Publishers 1991, originally published in 1932).

<sup>350</sup> *ibid.*

<sup>351</sup> E Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288; F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991); J Solomon and A Solomon, *Corporate Governance and Accountability* (John Wiley & Sons Ltd. 2003) 17.

<sup>352</sup> S Sheikh and W Rees (eds), *Corporate Governance & Corporate Control* (Cavendish 1995) 10; *Hutton v West Cork Railway Co. Ltd.* [1883] 23 Ch. D. 654, 673.

<sup>353</sup> H Hansmann and R Kraakman, 'The end of history for corporate law' (2001) 89 *Geo.L.J.* 439, 448.

<sup>354</sup> F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 12;

W Allen, 'Contracts and communities in corporation law' (1993) 50 *Wash. & Lee L. Rev* 1395, 1400; J Abugo, 'Directors' duties and the frontiers of corporate governance' (2011) *ICCLR* 322, 337.

obligations.<sup>355</sup> The shareholders therefore bear the risk of the company as their claim will be fulfilled last, although they have provided the investment.<sup>356</sup> Easterbrook and Fischel differentiate between the variable claim of the shareholders and the fixed claim of other parties linked to the company.<sup>357</sup> The size of the shareholders' claim therefore depends on the actions of the management. This situation is used as the justification for rewarding the shareholders by way of giving them control over the company and why directors must work in their interest, i.e. by the principle of maximising shareholder value.<sup>358</sup> In this model, shareholders become the owners of the company, or at least of the business, through the purchase of shares.<sup>359</sup> The shareholder value model is said to be clear and certain, as it provides a yardstick to measure the performance of directors.<sup>360</sup>

It has been argued that the shareholder value theory made claims irrelevant that a company should act in a socially responsible manner.<sup>361</sup> Drawing upon the idea that 'the manager is the agent of the individuals who own the corporation', Friedman argues that a director who acts in a socially responsible way would become a 'public employee', although, in fact, he is an 'employee of a private enterprise'.<sup>362</sup> Such a manager would impose taxes on the shareholders.<sup>363</sup> So, with this version of corporate theory, corporate governance and CSR do not overlap with each other as CSR is beyond the scope of corporate governance.

### 3.3.2.2 The stakeholder value theory

The stakeholder value theory, also known as the pluralist model or the productive coalition model<sup>364</sup>, proposes that a company should be run in the interest of all its stakeholders rather than just the shareholders.<sup>365</sup> This theory can therefore be

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<sup>355</sup> F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 25.

<sup>356</sup> D Fisher, 'The enlightened shareholder value – leaving stakeholders in the dark: will section 172 (1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) *ICCLR* 10, 11.

<sup>357</sup> F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 37.

<sup>358</sup> H Hansmann and R Kraakman, 'The end of history for corporate law' (2001) 89 *Geo.L.J.* 439, 449.

<sup>359</sup> H Hansmann, 'Ownership of the firm' (1988) 4 *Journal of Law, Economics and Organisation* 267.

<sup>360</sup> See for a discussion of this point: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 18-20.

<sup>361</sup> D Millon, 'Theories of the corporation' (1990) *Duke Law Journal* 201, 225.

<sup>362</sup> M Friedman, 'The Social Responsibility of Business is to Increase its Profits' *New York Times* (New York 13 September 1970) § 6 Magazine.

<sup>363</sup> *ibid.*

<sup>364</sup> M Blair and L Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

<sup>365</sup> R Freeman, *Strategic Management: A Stakeholder Approach* (Pitman/Ballinger 1984); G Vinten, 'Shareholder versus stakeholder – Is there a governance dilemma?' (2001) 9 *Corporate Governance* 36, 37.



characterised by its recognition of all stakeholders' interests.<sup>366</sup> All parties affected by the activities of the company should be given a place in corporate decision-making, albeit differentiated in nature and degree.<sup>367</sup> Directors have the obligation to balance conflicting interests of all stakeholders and they should not automatically give priority to the shareholders.<sup>368</sup> The underlying idea of this approach is that the company functions as a social institution whose conduct has an important impact on people's lives. The proponents of the stakeholder value theory emphasise that individuals owe obligations to each other in a community independently of contract.<sup>369</sup> Senior managers are seen as the trustees of the corporation's assets which they strive to sustain. According to this model, companies should seek to maximise the total creation of wealth instead of purely maximising profit.<sup>370</sup> Supporters of the stakeholder value theory question the theoretical underpinnings of the shareholder value theory. In particular, it is disputed that shareholders 'own' the company.<sup>371</sup> The argument is that, by purchasing shares, shareholders would acquire a title to the shares but not to the company. They can therefore not 'own' the company. This argument would follow from the company's separate personality (as evolved in the case *Salomon v Salomon*<sup>372</sup>). Moreover, proponents of the stakeholder value theory argue that shareholders are not the only constituents who invest in the firm and have a stake in it.<sup>373</sup> For example, employees invest in training which is tailored to the needs of the firm or suppliers invest in machines which produce goods needed by a specific company to which they supply goods (called 'firm-specific investment').<sup>374</sup> The stakeholder value theory is based on the idea that the interests of these stakeholders should not be subordinated to those of the shareholders, as the company benefits from the investments of all its stakeholders.<sup>375</sup>

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<sup>366</sup> The term stakeholder is unclear. Freeman has defined stakeholders as 'any group or individual who can affect or is affected by the achievement of the organisation's objectives', see: R Freeman, *Strategic management: A stakeholder approach* (Pitman/Ballinger 1984) 246. See for an overview of the discussion: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 47.

<sup>367</sup> J Dean, 'Stakeholding and company law' (2001) *Company Lawyer* 66, 69.

<sup>368</sup> Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) para 5.1.13.

<sup>369</sup> D Millon, 'Communitarians, contractarians, and the crisis in corporate law' (1993) 50 *Wash. & Lee L.Rev.* 1373, 1382.

<sup>370</sup> J Kay and A Silberston, 'Corporate governance', available at: <http://www.johnkay.com> (last accessed: 13/12/12).

<sup>371</sup> P Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 *MLR* 32.

<sup>372</sup> *Salomon v Salomon & Co* [1897] AC 22.

<sup>373</sup> G Kelly and J Parkinson, 'The conceptual foundations of the company: A pluralist approach' [1998] *CfILR* 174, 188.

<sup>374</sup> *ibid.*

<sup>375</sup> J Dean, 'Stakeholding and company law' (2001) *Company Lawyer* 66, 69. Moreover, linked to this argument, it is important to take account of a recent study that has researched from the year 1993 to 2009 the performance of 180 companies that have either voluntarily adopted sustainability mechanisms

Blair and Stout view the public corporation as 'a team of people who enter into a complex agreement to work together for their mutual gain'.<sup>376</sup> In their view, all members of the team have agreed to give up control rights and, consequently, no member of the team is a principal of the other team members.<sup>377</sup> The corporation operates under a 'mediating hierarchy'.<sup>378</sup> Blair and Stout focus on the central position of the board of directors who are given the control rights over the company.<sup>379</sup> The directors are 'trustees for the corporation itself'.<sup>380</sup> They are 'mediating hierarchs' who balance the competing interests of the various members of the team in a way that ensures the functioning of the productive coalition.<sup>381</sup> The model is significant on two grounds. First, it treats the various stakeholders as members of a productive team. Secondly, it focusses on the power of the board to make decisions for the business as a whole, without the need to prioritise the interests of the shareholders. Contradicting the claims brought forward by proponents of the shareholder value theory, Blair and Stout emphasise that shareholders have only limited scope to successfully sue directors for their decisions due to an 'expansive judicial interpretation of the business judgment rule'<sup>382</sup> which gives much discretion to the directors to make decisions on behalf of the company. This argument effectively leads to managerialism.

With its emphasis on the team production process, this model of the company enables directors to pursue the interests of all groups affected by a company, i.e. to act in a socially responsible way. The directors are given discretion to make decisions that benefit the team as a whole. Under this version of corporate theory, corporate governance and CSR are coterminous.<sup>383</sup> Corporate governance allows

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or that have followed a traditional profit maximisation approach. The results from that study show that in 2009 those companies which have voluntarily pursued CSR matters (names as High Sustainability companies) have outperformed those that have not both in terms of stock market and accounting measures. The study matched a sample of 180 companies. 90 companies were classified as High Sustainability companies due to their voluntary adoption of CSR policies. The other 90 companies were classified as Low Sustainability firms because they had not adopted policies guiding their impact on the society and the environment. See: R Eccles, I Ioannou and G Serafeim, 'The Impact of Corporate Sustainability on Organizational Processes and Performance', (2011) Harvard Business School Working Paper, 12-035, available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1964011](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1964011) (last accessed: 21/05/2013).

<sup>376</sup> M Blair and L Stout, 'A team production theory of corporate law' (1999) 85 *Virginia Law Review* 247, 278.

<sup>377</sup> *ibid*, 277.

<sup>378</sup> *Ibid*, 278.

<sup>379</sup> *ibid*, 276.

<sup>380</sup> *ibid*, 281.

<sup>381</sup> *ibid*.

<sup>382</sup> *ibid*, 320. The business judgment rule is explained in the following way: '...directors of a corporation...are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge...', see: *Gimbel v. Signal Cos.*, 316 A.2d 599, 608 (Del. Ch. 1974).

<sup>383</sup> J Solomon and A Solomon, *Corporate Governance and Accountability* (John Wiley & Sons Ltd. 2003) 24.

the promotion of CSR goals, as priority should not automatically be given to shareholders. The reason for pursuing CSR can be based both on the argument that it ensures the productive functioning of the team, as well as the idea that the company is a social institution.

### 3.3.2.3 The enlightened shareholder value theory

Following a discussion of these two theories, the government's White Paper finally settled upon an approach which it calls the 'inclusive approach'.<sup>384</sup> This approach is known as the 'enlightened shareholder value theory'.<sup>385</sup> It was seen as a possible 'third way', an alternative to strict shareholder primacy on the one hand and the stakeholder value theory on the other hand.<sup>386</sup> The enlightened shareholder value theory continues to give primacy ultimately to the interests of shareholders, but it requires directors also to consider other factors related to the interests of various other stakeholders who are affected by the company.<sup>387</sup> This theory is premised on the belief that long-term profit maximisation can only occur through the fostering of co-operative relationships with the various non-shareholder constituents.<sup>388</sup> It is argued that this theory would better promote wealth generation and competitiveness for the benefit of all. The enlightened shareholder value model is embedded in the shareholder value theory<sup>389</sup> as directors have to act in the collective best interest of shareholders.<sup>390</sup> However, the directors are also required to recognise the company's need to promote its relationships with employees and suppliers and its impact on the environment as well as the community.<sup>391</sup> This theory does not support purely short-term financial benefits, but rather promotes the pursuing of long-term gains.<sup>392</sup> The focus on short-term gains used to be a common criticism of

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<sup>384</sup> Company Law Review, *The White Paper: Modernising Company Law* (DTI 2002, Cm 5553-I and Cm 5553-II) para 3.3. See for an overview of the background to the adoption of the enlightened shareholder value model: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) chapter 3.

<sup>385</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 1.6.4.3. See for a detailed analysis of the enlightened shareholder value model: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013).

<sup>386</sup> D Millon, 'Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without law' in P M Vasudev and S Watson (eds), *Corporate Governance after the Financial Crisis* (Edward Elgar 2012) 69.

<sup>387</sup> J K S Ho, 'Is section 172 of the Companies Act 2006 the guidance for CSR?' (2010) *Company Lawyer* 207, 209.

<sup>388</sup> L Roach, 'The legal model of the company and the company law review' (2005) 26 *Company Lawyer* 98, 99.

<sup>389</sup> A Keay, 'Section 172(1) of the Companies Act 2006: an interpretation and assessment' (2007) *Company Lawyer* 106, 107.

<sup>390</sup> Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) para 2.22.

<sup>391</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 223.

<sup>392</sup> Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) para 2.22.

British businesses in the 1980s and 1990s.<sup>393</sup> A study conducted by the Institute of Directors in 1999 found out that many directors thought they were legally required to maximise short-term shareholder benefits to the detriment of long-term profit.<sup>394</sup> The Company Law Review Steering Group therefore identified directors' duties as well as corporate reporting duties to be important for the implementation of the enlightened shareholder value doctrine.<sup>395</sup> The enlightened shareholder value theory is said to be enshrined in the duty of directors to promote the success of the company in s172 (1) CA.<sup>396</sup> Although the enlightened shareholder value theory does not support an understanding of corporate governance and CSR as coterminous, as the stakeholder value theory does, Millon states that it 'resonates with notions of CSR'.<sup>397</sup> In Yap's view, the concept of CSR lies behind the enlightened shareholder value principle.<sup>398</sup> Moreover, Horrigan argues that the reform of UK company law 'is pregnant with potential CSR implications'.<sup>399</sup>

With its emphasis on fostering relationships with all stakeholders, the enlightened shareholder model at least potentially opens up the scope of corporate governance for CSR. This argument can be based on the fact that s172 (1) CA requires directors to have regard to the various stakeholders of the company and not just the shareholders. Under this model of the corporation, CSR falls, at least potentially, within the scope of corporate governance.<sup>400</sup> To what extent company law and corporate governance, within the enlightened shareholder model, actually promote the socially responsible conduct of companies will be analysed in the following part of the chapter. The analysis will first address the two areas identified by the Company Law Review Steering Group for the implementation of the enlightened shareholder value approach, namely directors' duties (s172 CA) and the business review (s417 CA). It will then address two further areas of company law and corporate governance that can contribute to the promotion of CSR: Shareholders'

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<sup>393</sup> Commission on Public Policy and British Business, *Promoting Prosperity: A Business Agenda for Britain* (Vintage 1997).

<sup>394</sup> Institute of Directors, *Good Boardroom Practice* (IOD 1999).

<sup>395</sup> Company Law Review, *Modern Company Law, Final Report* (DTI 2001) para 3.8. As will be outlined in the section on the business review, it was originally planned to require companies to compile an Operating and Financial Review (OFR). The OFR was finally abandoned and substituted by the business review. The OFR was intended to compel listed companies to disclose a range of 'qualitative' and 'forward-looking' information, for example about the relationships with employees. See also: A Johnston, 'After the OFR: Can UK Shareholder Value Still be Enlightened?' (2006) *EBOLR* 817, 828.

<sup>396</sup> S Wen, 'The magnitude of shareholder value as the overriding objective in the UK: the post-crisis perspective' (2011) *Journal of International Banking Law and Regulation* 325, 330.

<sup>397</sup> D Millon, 'Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without law' in P M Vasudev and S Watson (eds), *Corporate Governance after the Financial Crisis* (Edward Elgar 2012) 68.

<sup>398</sup> J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37.

<sup>399</sup> B Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 229.

<sup>400</sup> Johnston critically asks if shareholder value will still be enlightened in the absence of a statutory OFR, see: 'After the OFR: Can UK Shareholder Value Still be Enlightened?' (2006) *EBOLR* 817.

remedies and the board (the role of non-existing directors as well as the composition of the board).

### **3.4 The promotion of CSR in English company law and corporate governance**

#### **3.4.1 Directors' duties: The duty to promote the success of the company (s172 CA)**

The duty to promote the success of the company in s172 (1) CA<sup>401</sup> has been met with much interest both in academia and in practice since its implementation into the Companies Act 2006.<sup>402</sup> Prior to this Act, directors' duties were not regulated within the Companies Act, but based on common law. It has been argued that the duty in s172 CA encapsulates in statute the enlightened shareholder value theory.<sup>403</sup> Accepting this interpretation, this section analyses to what extent this duty promotes CSR. The analysis of s172 (1) CA will first look at the overlap between the duty and CSR. It will then interpret the meaning of the individual components of s172 (1) CA which are: 'good faith', 'success of the company for the benefit of its members as a whole' and 'having regard to', and their effect on pursuing CSR aims. S172 CA will be analysed with regard to its wording, its review in the academic literature and with references to the case law. Finally, this section of the chapter will analyse the enforceability of s172 (1) CA.

##### **3.4.1.1 Overlap between s172 CA and CSR**

One important question for this thesis is whether the duty in s172 CA overlaps with the concept of CSR. S172 (1) CA enlists a number of factors that a director must 'have regard to' when discharging his duty to promote the success of the company for the benefit of its members as a whole.

The list of factors in s172 (1) CA explicitly refers to various stakeholders, such as the employees, the suppliers, customers, as well as the community and the environment. This list overlaps with the definition of CSR adopted in this thesis,

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<sup>401</sup> S172 (1) CA reads as follows: '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 decisions in the long term, (b) the interests of the company's employees, (c) the need to foster 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 and (f) the need to act fairly between members of the company.'

<sup>402</sup> See for example: A Keay, 'The duty to promote the success of the company: is it fit for purpose in a post-financial crisis world?' in J Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 50; J Loughrey, A Keay and L Cerioni, 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 (1) *JCLS* 79; J K S Ho, 'Is section 172 of the Companies Act 2006 the guidance for CSR?' (2010) *Company Lawyer* 207; A Keay, 'Section 172 (1) of the Companies Act 2006: an interpretation and assessment' (2007) *Company Lawyer* 106.

<sup>403</sup> J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37.

according to which companies have an obligation to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders but also employees, consumers, suppliers, creditors and local communities.<sup>404</sup> This definition of CSR also refers to environmental, human rights and ‘quality of life’ concerns. So, on comparison, several of the factors that are referred to in s172 (1) CA are also expressly included in the CSR definition adopted here. These are employees, suppliers, customers and others, the impact on the community and environment. Hence, there is a considerable overlap between the s172 (1) CA and CSR, although the two are not entirely coterminous.

Although the list in s172 (1) CA does not expressly refer to creditors, they are mentioned in s172 (3) CA which stipulates that the duty in s172 (1) CA ‘has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company’. This provision refers to the common law principle that directors of an insolvent company must consider the interests of its creditors.<sup>405</sup> Whereas the previous Companies Act 1985 expressly mentioned employees in a separate section of the Act (s309), they are now part of the list of factors in s172 (1) CA. Although several factors are given explicit mention in s172 (1) CA the list of factors is non-exhaustive, as indicated by the clause ‘amongst other matters’.

The duty of directors to consider some of the factors now contained in s172 (1) CA is not entirely new, but a mere repetition of the previous legal situation.<sup>406</sup> Apart from the employees<sup>407</sup> and the creditors<sup>408</sup>, this point applies to the need to act fairly as between members of the company<sup>409</sup> and the obligation to have regard to the likely consequences of any decision in the long term<sup>410</sup>. These issues were recognised as interests a director needs to consider in the old common law. The factors that are indeed new are the need to foster business relationships with suppliers, customers and others<sup>411</sup>, the impact of operations on the community and the environment<sup>412</sup> and the desirability of maintaining a reputation for high standards of business

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<sup>404</sup> K Campbell and D Vick, ‘Disclosure Law and the market for corporate social responsibility’ in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability* (CUP 2007) 242.

<sup>405</sup> *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

<sup>406</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-29.

<sup>407</sup> S309 Companies Act 1985.

<sup>408</sup> *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

<sup>409</sup> *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11. This duty is now found in s172 (1) (f) CA.

<sup>410</sup> *Gaiman v National Association for Mental Health* [1971] Ch 317, at 330. This duty is now found in s172 (1) (a) CA.

<sup>411</sup> S172 (1) (c) CA.

<sup>412</sup> S172 (1) (d) CA.

conduct<sup>413</sup>. The effect of this expansion of factors in s172 (1) CA is that when directors discharge their duty to act in the best interest of the company, they must consider a wider spectrum of aspects than under the previous situation. The new duty is therefore considered to be more inclusive.<sup>414</sup>

Based on these considerations, it can be stated that the list of factors in s172 CA overlaps with many concerns of CSR, but that the inclusion of some of these considerations into the decision-making process is not entirely new for directors' duties. Nevertheless, due to the overlap between the list of factors in s172 (1) CA and CSR, it has been argued that CSR is 'implicit in s172'.<sup>415</sup> Similarly, Ho opines that s172 provides the guidance for CSR.<sup>416</sup> The Ministerial Statements by Margaret Hodge claim that section 172 CA would 'mark a radical departure in articulating the connection between what is good for a company and what is good for society at large.'<sup>417</sup> She went on to give CSR a mention in this context by stating that 'Corporate social responsibility has developed and evolved over time.'<sup>418</sup> All of the factors considered so far suggest a clear correlation between s172 (1) CA and CSR. The question remains, however, to what extent this duty of directors in s172 CA actually promotes or has the potential to promote CSR. This issue will be analysed in the next part by looking at the different components of the section.

#### **3.4.1.2 Good faith**

The duty in s172 CA requires a director to act in the way he considers in good faith would be in the best interest of the company. The relevant question for the promotion of CSR through s172 (1) CA is what standard the courts apply to this test when assessing the issue if a director has breached his duty to promote the success of the company for the benefit of its members as a whole.

The wording of s172 (1) CA emphasises the terms 'he considers' and 'in good faith'. The inclusion of these two terms gives priority to the director's judgement. These terms put the emphasis on what the director considers, in good faith, to be in the best interest of the company, and not on the views of third parties, for instance the court. Through this emphasis, the section distinguishes between the considerations of the director and the court. This situation is in line with the approach which was

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<sup>413</sup> S172 (1) (f) CA.

<sup>414</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-29.

<sup>415</sup> J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37.

<sup>416</sup> J K S Ho, 'Is section 172 of the Companies Act 2006 the guidance for CSR?' (2010) *Company Lawyer* 207, 210.

<sup>417</sup> DTI, 'Companies Act 2006, Duties of company directors, Ministerial statements' Introduction by Margaret Hodge (2007) 1.

<sup>418</sup> *ibid.*

taken to the previous common law duty to act bona fide for the company before the codification of directors' duties in the Companies Act 2006.<sup>419</sup> As s170 (4) CA stipulates a requirement to interpret the general duties in the same way as common law rules or equitable principles, it is likely that the courts will refer to the case law pertaining to the old common law duty to act bona fide for the company when interpreting the 'good faith' provision. The reason is that 'good faith' can be seen as a continuation of the previous 'bona fide' requirement. This interpretation was indicated in the case *Cobden Investments Ltd v RWM Langport Ltd*<sup>420</sup> which was decided after the enactment of the Companies Act 2006 and where the judge said

The perhaps old-fashioned phrase acting '*bona fide* in the interests of the company' is reflected in the statutory words acting 'in good faith in a way most likely to promote the success of the company for the benefit of its members as a whole'. They come to the same thing with the modern formulation giving a more readily understood definition of the scope of the duty.<sup>421</sup>

The traditional approach to acting 'bona fide' is embodied in the case *Re Smith and Fawcett Ltd*<sup>422</sup> in which it was held that directors of a company must act '...bona fide in what they consider – not what a court may consider – is in the interest of the company, and not for any collateral purpose'. The test was discussed in the case *Regentcrest plc v Cohen* where the court emphasised that it would focus on 'the director's state of mind'.<sup>423</sup> This formulation of the court indicates that the test is a subjective one. This situation demonstrates that the courts are unwilling to interfere with the judgement of the directors 'with the benefit of hindsight'.<sup>424</sup> The interpretation of 'good faith' in s172 CA taken in *Cobden Investments Ltd v RWM Langport Ltd*<sup>425</sup> was followed in other recent decisions which were made after the enactment of the Companies Act 2006. In *Iesini v Westrip Holdings Ltd*<sup>426</sup>, the court held that it was not in the best position to make judgements about the weight of the considerations in s172 CA except in very clear cases as these are commercial issues and the director's subjective judgements would prevail in these circumstances.

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<sup>419</sup> A Keay, 'Good faith and directors' duty to promote the success of their company' (2011) *Company Lawyer* 138, 139.

<sup>420</sup> [2008] EWHC 2810 (Ch) [52].

<sup>421</sup> *Cobden Investments Limited v RWM Langport Ltd, Southern Counties Fresh Foods Limited, Romford Wholesale Meats Limited* [2008] EWHC 2810 (Ch) [52].

<sup>422</sup> [1942] Ch 304 [306].

<sup>423</sup> [2001] 2 BCLC 80 [105]. The court held that: 'The question is not whether, viewed objectively by the court, the particular act or omission which is challenged, was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather the question is whether the director honestly believed that his act or omission was in the interest of the company. The issue is as to the director's state of mind.'

<sup>424</sup> *Ibid*, [106]-[107].

<sup>425</sup> [2008] EWHC 2810 (Ch).

<sup>426</sup> [2009] EWHC 2526.



The courts are therefore not likely to second-guess decisions by the directors with regard to how to promote the success of the company. This finding has ramifications for the importance given to the interests of the various stakeholders, enlisted in s172 (1) CA. As the good faith test is firmly grounded in subjectivity, the key point for assessing how directors have discharged their duty is their subjective opinion as to whether a decision was meant to promote the best interest of the company. It will therefore be difficult to find directors to be in breach of their s172 (1) CA duty as long as they can convince the judge that they acted in good faith in their decision-making. This situation is a severe limitation of the enforcement of the duty to consider the interests of the various stakeholders through s172 (1) CA. In turn, it means that although s172 (1) CA overlaps with the concept of CSR, it is doubtful if CSR will be promoted through this duty. It rather remains in the discretion of directors to consider how to balance the interests of the various stakeholders and how much weight to give to these in the decision-making process.

#### **3.4.1.3 Success of the company for the benefit of the members as a whole**

The next issue is what the term ‘success of the company for the benefit of its members as a whole’ means for the pursuing of CSR goals. The directors must have regard to the list of factors in s172 (1) CA when working towards promoting the success of the company. It will be analysed here to what extent CSR forms part of the goal of promoting the ‘success’ of the company. Keay points out that there is no indication in s172 (1) CA as to the meaning of what fulfils the requirement ‘success of the company’.<sup>427</sup> He suspects that this is because directors can fulfil their duty to promote the success of the company under the same preconditions as the ‘good faith’ requirement, i.e. when they believe their action to do so, even if it does not objectively.

The Guidance on Key Clauses in the Company Law Reform Bill states that

the decision as to what will promote success, and what constitutes such success, is one for the directors’ good faith judgment. This ensures that business decisions on, for example, strategy and tactics are for the directors and not subject to decisions by the courts, subject to good faith.<sup>428</sup>

Guidance as to what constitutes ‘success of the company’ can be found in the case law pertaining to the common law prior to the Companies Act 2006. In fact, the ‘new’ duty in s172 CA has its origins in the previous common law fiduciary duty for directors to act bona fide in what they consider to be in the best interests of the

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<sup>427</sup> A Keay, ‘Section 172(1) of the Companies Act 2006: an interpretation and assessment’ (2007) *Company Lawyer* 106, 109.

<sup>428</sup> DTI, Guidance on Key Clauses to the Company Law Reform Bill (2005) para 63.

company.<sup>429</sup> In this common law duty, the interest of the company was interpreted as meaning the shareholders as a general body. The notion of promoting the interests of the various stakeholders of the company was not included in this concept. This interpretation led to the idea of enhancing shareholder value.<sup>430</sup> The shareholder-centricity of English company law can be traced back to the origins of English company law which evolved out of partnership law in the 19<sup>th</sup> century.<sup>431</sup> At that time the shareholders were considered to be 'the company' (i.e. the joint stock company), as there was not yet any conception of the company as an object separate from its shareholders. Despite this long history of shareholder-centricity of English company law, the focus of directors on maximising shareholder value has been particularly dominant in the US and the UK since the 1980s.<sup>432</sup> The concept of CSR with its focus on the interests of the stakeholders does not form part of this concept, unless it promotes the value of the shareholders.

Under the s172 (1) CA duty, directors must promote the success of the company for the benefit of its members as a whole. Membership of a company is normally based on shareholding.<sup>433</sup> The expression 'members as a whole' is understood by the courts as present and future shareholders.<sup>434</sup> This prioritisation of shareholders suggests that directors are only allowed to pursue CSR if it ultimately benefits the shareholders. CSR can therefore easily be reduced to a secondary issue in the directors' decision-making process. Parliamentary debates about the new Companies Act acknowledged that success is usually measured by the long-term increase of shareholder value, but it may also be fulfilled by pursuing other goals, if that is the purpose of the firm.<sup>435</sup> The Company Law Review Steering Group declared that it inserted 'success of the company for the benefit of its members as a whole' into the provision in order to emphasise that the directors do not work to favour the individual interests of members, but for the interests of the members as

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<sup>429</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-1.

<sup>430</sup> *Hutton v West Cork Railway Company* (1883) 23 Ch. D. 654; *Re Smith & Facett Ltd* [1942] Ch [304], [306]; *Second Savoy Hotel Investigation*, Report of the Inspector (1954) HMSO; *Parke v Daily News Ltd* [1962] Ch. 927; *Gaiman v National Association for Mental Health* [1971] Ch 317.

<sup>431</sup> P Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 *MLR* 32, 39. See for an historical overview: P Ireland, 'Limited liability, shareholder rights and the problem of corporate irresponsibility' (2010) 34 *Cambridge Journal of Economics* 837.

<sup>432</sup> M Omran, P Atrill and J Pointon, 'Shareholders versus stakeholders: corporate mission statements and investor returns' (2002) 11 *Business Ethics: A European Review* 318. It is said that the exclusive focus of corporations on shareholder value developed during the Reagan and Thatcher years, see: W Lazonick and M O'Sullivan, 'Maximizing shareholder value: a new ideology for corporate governance' (2000) 29 *Economy and Society* 13, 14.

<sup>433</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 14.2.

<sup>434</sup> See *Gaiman v National Association for Mental Health* (1971) Ch [317], [330].

<sup>435</sup> HL Deb, vol 678, GC 255-8 (6 February 2006).

an association.<sup>436</sup> This approach is further supported by the fact that one of the factors to which directors must have regard when discharging their s172 CA duty is 'to act fairly as between members of the company'.<sup>437</sup>

Although there has so far not been much case law about the new duty in s172 CA, it seems that the courts, by and large, considered it to be merely the codification of the previous duty to act bona fide in the best interest of the company.<sup>438</sup> This finding suggests that 'success of the company' is a continuation of the duty under the old common law to work in 'the best interests of the company' with the ultimate goal of the directors' decisions being the promotion of the benefit of the shareholders. This interpretation further supports the view taken here that the goal to promote the success of the company for the benefit of its members as a whole in s172 (1) CA still prioritises the enhancing of shareholder value. Stakeholders and hence the concept of CSR are not given a prominent role in the term 'success of the company'. Although CSR might be implicit in s172 (1) CA<sup>439</sup>, this duty of directors is limited in its ability to promote CSR. The impact of CSR on the directors' decision-making will be limited to those instances where there is a clear business case for pursuing CSR objects.

#### **3.4.1.4 Having regard to list of factors**

Whilst it was outlined above that there is a significant overlap between the list of factors in s172 (1) CA and the concept of CSR, the question remains what role these factors play in the decision-making process of directors. This issue depends on how one interprets the duty of directors to 'have regard to' the list of factors.

The first issue in relation to the phrase 'having regard to' is that the list of factors in s172 (1) CA does not contain any guidance about how directors should balance between the different factors enlisted in s172 (1) CA. There is a lack of clarity about the weight given to the various factors. This is particularly a problem in case of competing interests, e.g. where a decision favours one factor (e.g. the environment), but disadvantages another factor (e.g. the employees).<sup>440</sup> It is also not made clear in the provision if directors are obliged to choose the factor that is likely to be most

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<sup>436</sup> The Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) para 3.51.

<sup>437</sup> S172 (1) (f) CA.

<sup>438</sup> *Re West Coast Capital (LIOS) Ltd* [2008] CSOH [72]; *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).

<sup>439</sup> J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37.

<sup>440</sup> This was also criticized by Yap, see J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37.

beneficial for shareholders in a particular situation.<sup>441</sup> However, seeing that 'success of the company' is interpreted to favour the interests of shareholders it seems that every factor may only be taken into account insofar as it ultimately favours the interests of the company's members, i.e. the shareholders.

The second issue is that s172 (1) CA only requires directors to 'have regard to' the factors whilst they discharge their duty to promote the success of the company for the benefit of the members as a whole. 'Having regard to' is a very vague concept which does not mandate more than to consider the factors enlisted in s172 (1) CA. It seems that the relationship between the 'success of the company for the benefit of its members as a whole' and 'having regard' to the list of factors is one of subordination. The analysis of 'success of the company' in the previous part has shown that directors must ultimately strive to enhance shareholder value when they work towards the promotion of the success of the company. The same finding applies in relation to the provision 'having regard to'. Directors must 'only' have regard to the list of factors in s172 (1) CA whilst they promote the interests of the members as a whole, i.e. the shareholders.

Thirdly, with regard to the role of employees as one key stakeholder group, one could even go as far as viewing the provision in s172 (1) CA as a change of the law to the worse. The reason is that the previous Companies Act 1985 mentioned employees in a separate provision<sup>442</sup> without express subordination under shareholder value as in s172 CA. S309 Companies Act 1985 stipulated that directors must have regard to the interests of the company's employees in general as well as the interests of its members. The reason for the abolishment of this previously separate section regarding the position of the company's employees in the new Companies Act 2006 is that the Company Law Review Steering Group did not want to see the interests of employees favoured above those of the shareholders.<sup>443</sup> The duty in s172 (1) CA therefore not only subordinates the concept of CSR under the goal of enhancing shareholder value, it also has had a detrimental effect on the recognition of employees, as these are now only part of the non-exhaustive list of factors in s172 (1) CA.

Fourthly, the little case law that exists about s172 (1) CA further adds to the cautious view taken here about the role of the stakeholders listed in s172 (1) CA in the directors' decision-making process. The recent case *R. (on the application of People*

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<sup>441</sup> A Keay, 'Enlightened shareholder value' [2006] *LMCLQ* 335, 352.

<sup>442</sup> S309 Companies Act 1985.

<sup>443</sup> The Company Law Review, *Modern Company Law for a Competitive Economy: the Strategic Framework* (DTI 1999) paras 5.1.20 to 5.1.23.

& Planet) v HM Treasury<sup>444</sup> is important for the analysis about how directors must 'have regard to' the list of factors. Here, the High Court had the opportunity to consider the scope of the duty in s172 CA and the importance of the interests of the stakeholders. The case was brought against the government as it had bought a stake of about 84 per cent of the shares of the Royal Bank of Scotland (RBS).<sup>445</sup> The government's ownership of RBS was arranged through a limited company, UK Financial Investments Ltd (UKFI).<sup>446</sup> RBS is a significant provider of financing to the energy industry. This situation led to a challenge by activists of the student network People & Planet which works in the areas of poverty, human rights and the environment. People & Planet disagreed with HM Treasury Policy regarding UKFI's management of RBS on the basis of the statutory norms regarding the protection of the environment in s172 (1) CA.<sup>447</sup> Due to the peculiarities with the government owning the shares, the litigation in this case was not based on a shareholder derivative action, but on judicial review. The government agreed to a policy document in which it decided not to intervene in the day-to-day management decisions. This approach confirmed a commercial approach as the best way for UKFI to achieve its objectives. The court rejected the application for permission to bring judicial review proceedings. It argued that to go beyond the commercial approach would 'cut across the fundamental legal duty of boards to manage their companies in the interest of all their shareholders'.<sup>448</sup>

Notably, the court held that had the government sought to impose its own policy on combating climate change and promoting human rights on the board of RBS, this would have 'cut across the duties of the RBS Board as set out in s172 (1)'.<sup>449</sup> UKFI could properly seek to influence the board of RBS to have regard to environmental and human rights considerations in accordance with its duty under s172 CA 2006, but this would be a step too far for the Treasury. This decision is significant as the court noted that, if shareholders seek to influence the decisions of the management, they could only influence directors to act within the constraints of s172 CA (which means the shareholder prerogative). The limit of enforcing the consideration of the list of factors in s172 (1) CA is therefore the promotion of shareholder value. Consequently, CSR considerations may only be pursued to the extent that these promote the business case. Secondly, the court pointed out that there is then a risk

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<sup>444</sup> [2009] EWHC 3020 (Admin) (QBD (Admin))

<sup>445</sup> J Treanor, 'RBS axes 3,700 jobs as taxpayer stake hits 84%', The Guardian, 2 November 2009, available at: <http://www.guardian.co.uk/business/2009/nov/02/rbs-slash-costs-cuts-jobs> (last accessed 14/12/2012).

<sup>446</sup> UKFI Annual Report 2008/9, 46.

<sup>447</sup> S Cobby, 's172 of the Companies Act 2006 fails people and planet?' (2010) *Company Lawyer* 406.

<sup>448</sup> *R. (on the Application of People and Planet) v HM Treasury* [2009] EWHC 3020 (Admin), [13e].

<sup>449</sup> *ibid.*, at para 34.

of litigation by minority shareholders who could complain that the value of their shares had been detrimentally affected.<sup>450</sup> This argument further supports the interpretation of the previous point that the stakeholder-oriented considerations to which a director must have regard in s172 (1) CA are subordinated under the interests of the shareholders. Following the High Court's decision, one should be cautious as to the effect of s172 (1) CA on the promotion of CSR.

The analysis of the meaning of 'having regard to' has shown that the interests of the members are given priority over the various stakeholders referred to in the non-exhaustive list of factors in the second part of s172 (1) CA.<sup>451</sup> Effectively this means that the concept of CSR is not considered as an end in itself, but only as a means to an end, namely to increase shareholder value. The term 'having regard to' subordinates CSR under the goal of enhancing shareholder value. The interests of shareholders are prioritised through the phrase 'having regard to' as these factors are only considered as aspects a director must consider when pursuing the ultimate goal of promoting the interests of the company's members. This finding is in line with the interpretation of 'success of the company' which has shown that the interests of shareholders are favoured in the decision-making process. There is thus an emerging picture in the analysis here that s172 (1) CA is still firmly embedded in the tradition of the shareholder value doctrine. CSR has been left to be a side-aspect of the decision-making process. Although CSR is implicit in s172 (1) CA, its practical impact is likely to be very limited due to the overriding prioritisation of shareholders. The duty in s172 (1) CA therefore effectively continues to prioritise shareholder value. CSR is only a secondary consideration for directors.

#### **3.4.1.5 Enforceability**

Having analysed the different components of s172 (1) CA with regard to their effect on the promotion of CSR, the question remains how enforceable claims about an alleged breach of this duty are. The principal position is that the proper claimant in respect of a wrong allegedly done to the company is the company ('proper plaintiff rule').<sup>452</sup> It is therefore up to the management to decide whether or not to pursue a

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<sup>450</sup> *ibid.*

<sup>451</sup> Pedamon criticises that the board's final decision might ignore all factors enlisted in s172 (1) CA as long as it can justify that it has at least considered them. This would reduce the consideration of the interests of the various stakeholders 'to a box-ticking exercise'. See C Pedamon, 'Corporate Social Responsibility: a new approach to promoting integrity and responsibility' (2010) *Company Lawyer* 172, 175. Key points out that there is no explanation given whether directors should consider stakeholder interests per se or only insofar as they benefit shareholders, A Keay, 'Enlightened shareholder value' [2006] *LMCLQ* 335, 352.

<sup>452</sup> *Foss v Harbottle* (1843) 2 Hare 461; see B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-13.

claim. The only group which could have a right to bring proceedings in case of an alleged breach of the s172 CA duty are shareholders. They can bring a derivative action pursuant to s260 CA. However, the subsequent analysis will show the limited ability of this claim in terms of enforcing s172 (1) in order to pursue CSR goals.

It is notable that the various groups listed in s172 (1) CA are not given legal standing in s172 CA. One can therefore argue that the provision lacks teeth in terms of the enforcement of the interests of these groups. This situation is likely to have a limiting effect on the promotion of CSR through s172 (1) CA. The reason is that the board of directors and the shareholders, as the only groups who have standing to bring a claim for an alleged breach of s172 (1) CA, are usually more concerned with the protection of their interests, i.e. the promotion of shareholder value. As the various stakeholders listed in s172 (1) CA cannot bring a claim for an alleged non-consideration of their interests, it is less likely that their interests are enforced at all, unless socially minded shareholders litigate. The practical effects of s172 (1) CA for the promotion of CSR are therefore further limited. It will be difficult to start an action or to prove a breach of s172 (1) CA.

The academic literature has consequently assessed the enforceability of s172 (1) CA in a rather cautious manner. Birds calls the effect of s172 CA 'likely to be educational rather than in any sense restrictive'.<sup>453</sup> In his opinion, business decisions taken in good faith will not be any more easily challengeable than they were prior to the CA 2006. This situation has been rightly called 'a right without a remedy'.<sup>454</sup> Keay therefore concludes that 'there is certainly an enforcement problem with the provision'.<sup>455</sup> He points out that there is an absence of significant case law with regard to this section even though the Companies Act has been in force for some years now.<sup>456</sup> There are a number of possible reasons for this situation in Keay's view: Cautious lawyers who are uncertain about the exact meaning and scope of the new duty, actions are still in the pipeline, directors are not breaching the provision or litigants rely on other provisions as the basis for actions against directors.<sup>457</sup>

On the basis of the analysis here, it seems that it is the way in which s172 (1) CA has been drafted, with its emphasis on good faith decisions of directors and its

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<sup>453</sup> J Birds et al. (eds), *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 16.5.1.

<sup>454</sup> D Fisher, 'The enlightened shareholder value – leaving stakeholders in the dark: will section 172 (1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) *ICCLR* 10, 15.

<sup>455</sup> A Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' in J Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 95.

<sup>456</sup> *ibid*, 86.

<sup>457</sup> *ibid*, 87.

prioritisation of shareholder value, that is the principal reason for the lack of enforcement of the provision.

#### **3.4.1.6 Concluding remarks regarding s172 (1) CA**

The analysis of the duty in s172 (1) CA provides a rather limited effect of this provision for the promotion of CSR.

The findings in this chapter contradict the statement made by the then Minister of State for Industry and the Regions Margaret Hodge who argued that s172 CA marked a 'radical departure in articulating the connection between what is good for a company and what is good for society at large'.<sup>458</sup> She also said that 'The law is now based on a new approach. Pursuing the interests of shareholders and embracing wider responsibilities are complementary purposes, not contradictory ones'.<sup>459</sup> Whilst the analysis in this chapter severely questions if the first claim of 'radical departure' is tenable, her reference to the complementary purposes does hint at the fact that the directors have a list of factors to consider. However, these factors are ultimately subordinated under the goal of increasing shareholder value, so CSR may be pursued only if it promotes the business case. The practical effects of the new duty for stakeholder concerns, and in particular for CSR, are restricted.

The priority attributed to shareholder value in s172 (1) CA is a continuation of the legal situation prior to the enactment of the Companies Act 2006. In particular, the analysis of the requirements 'good faith' and 'success of the company' in s172 (1) CA have revealed considerable conformity between the old common law duty to work bona fide in the interest of the company and s172 (1) CA. Where directors were previously required to work in the interest of the company, understood as meaning the shareholders as a general body, s172 (1) CA now stipulates that directors must promote the success of the company for the benefit of its members as a whole which are in fact the shareholders. This result demonstrates that CSR is only a secondary consideration for directors.

This outcome is further confirmed by the results of a recent evaluation of the Companies Act 2006, commissioned by the Department for Business Innovation & Skills (BIS).<sup>460</sup> The study showed that there is a need among business and

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<sup>458</sup> DTI, 'Companies Act 2006, Duties of company directors, Ministerial statements' Introduction by Margaret Hodge (2007), 1.

<sup>459</sup> *ibid*, 2.

<sup>460</sup> The evaluation is based on a quantitative telephone survey of 1001 businesses (amongst people in companies who are responsible for corporate governance) and in depth interviews of fifteen stakeholders. See: Department for Business Innovation & Skills, *Evaluation of the Companies Act*



stakeholders to add clarity and guidance for s172 CA in order to boost awareness and understanding to increase behavioural change.<sup>461</sup> The responses from businesses confirm the scepticism about the practical impact of s172 CA. Less than a fifth of companies overall which were aware of this duty agreed that it had affected the behaviour of directors, and over three-fifths disagreed that the change had impacted the behaviour of directors.<sup>462</sup> A further important distinction is that amongst interviewees significantly more directors disagreed that the change had affected their behaviour (91%) as opposed to non-directors (64%). These results show that although there is high awareness of the changes made in relation to directors' duties in the CA 2006 (79% were aware of this), only few directors have yet changed their decision-making process as a consequence of the new duty in s172 (1) CA. This evaluation provides for rather pessimistic reading from a CSR point of view. As the vast majority of directors have stated that they have not changed their decision-making, following the introduction of s172 CA, it is unlikely that they are going to pursue CSR goals to a greater extent than they have done before. This point further confirms the result of the analysis above: That the practical effects of s172 (1) CA for the promotion of CSR are limited.

It is significant that the study reveals that it is likely that there is no difference in the behaviour of directors if the directors are to make subjective judgments and if they are the same directors who were in that position prior to the enactment of the CA 2006.<sup>463</sup> This point is a very interesting one, as it indicates that the people who make the business decisions are key for the implementation of CSR into the business strategy. This issue underlines the importance of the board composition for the pursuing of CSR goals in the decision-making process of the company, as, for instance, non-executive directors are in a position to challenge business decisions and to add different viewpoints to debates, including those that are CSR related. The findings of the evaluation of the Companies Act 2006 by BIS make one wonder if the drafting of directors' duties alone is necessarily the most effective means to achieve CSR goals. It shows that the composition of the board (with directors coming from a more diverse background who represent different stakeholders), in

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2006, *Executive Summary* (2010), available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/E/10-1362-evaluation-companies-act-2006-executive-summary.pdf> (last accessed 15/05/2013).

<sup>461</sup> *ibid.*

<sup>462</sup> Department for Business, Innovation and Skills, *Evaluation of the Companies Act 2006, Volume One* (2010) 72 available at:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31655/10-1360-evaluation-companies-act-2006-volume-1.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31655/10-1360-evaluation-companies-act-2006-volume-1.pdf) (last accessed: 15/05/2013).

<sup>463</sup> N Okoye, 'The BIS review and section 172 of the Companies Act 2006: what manner of clarity is needed?' (2012) *Company Lawyer* 15, 16.

combination with the duty to consider the factors enlisted in s172 CA, might be better suited to the effective implementation of CSR through corporate governance. The aspect of the board composition will be discussed below.

In light of the findings of this section, it is doubtful if the enlightened shareholder value doctrine that underlies the s172 (1) CA duty really marks a shift away from the legal situation prior to the enactment of the Companies Act. At least directors have discretion in how they discharge this duty, including considerations above and beyond short-term shareholder gains. It is right that directors make 'good faith' decisions about the promotion of the interests of shareholders and the consideration of stakeholder interests which they can balance in different ways.<sup>464</sup> Nevertheless, this chapter has shown that this was already possible under the common law duties prior to the Companies Act 2006. Directors can promote CSR, if they believe that it promotes the benefit of the company in the long run, but CSR remains subordinated under shareholder value. Because shareholder value and the concerns of CSR are not always coincidental and might well be in conflict, this subordination is a severe limitation of the s172 (1) CA duty for the promotion of CSR.

In conclusion, it seems unlikely that the duty to promote the success of the company in s172 (1) CA will fundamentally change the way directors run the company under the Companies Act 2006. S172 (1) CA can therefore be regarded as a general statement with limited practical effects. It is still subject to what is called the 'historical magnitude of a corporation as a vehicle for shareholder value maximisation'.<sup>465</sup>

### **3.4.2 The business review (s417 CA)**

#### **3.4.2.1 Legislative requirements for the business review**

The duty to promote the success of the company pursuant to s172 (1) CA is linked with the business review in s417 CA. The enlightened shareholder value model was implemented through s172 CA as well as the business review.<sup>466</sup>

Companies are required to file a directors' report for each financial year of the company, s415 (1) CA. Pursuant to s417 (1) CA the directors' report must contain a business review, unless the company is entitled to the small companies exemption,

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<sup>464</sup> J K S Ho, 'Is section 172 of the Companies Act 2006 the guidance for CSR?' (2010) *Company Lawyer* 207, 212.

<sup>465</sup> S Wen, 'The magnitude of shareholder value as the overriding objective in the UK: the post-crisis perspective' (2011) *Journal of International Banking Law and Regulation* 325, 336.

<sup>466</sup> A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 83.

s415A CA. The purpose of the directors' report is to inform members of the company and help them assess how the directors have performed their duty under s172 CA.<sup>467</sup> The business review is relevant for this chapter insofar as the list of factors in 172 (1) CA to which a director must have regard when making decisions overlap with CSR. The reporting duty therefore requires directors to inform members about how they have discharged their duty to promote the success of the company, including the pursuing of CSR goals. With this transparency, the business review can contribute to the promotion of CSR. The current legislative reform of narrative reporting in the UK will be addressed later on this section, following the analysis of the business review in its present form.<sup>468</sup>

The business review must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company.<sup>469</sup> The review is (a) a balanced and comprehensive analysis of the development and performance of the company's business during the financial year and (b) the position of the company's business at the end of that year.<sup>470</sup> In case of a quoted company, s417 (5) CA further stipulates that the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business (a) include the main trends and factors likely to affect the future development, performance and position of the company's business and (b) (i) include information about environmental matters (including the impact of the company's business on the environment), (ii) the company's employees and (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies and (c) information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

It is important from a CSR point of view that, if the review does not contain information regarding the issues mentioned in s417 (5) (b) and (c) CA, it must only state which of these categories it does not contain. A business review must also include analysis using financial key performance indicators and, where appropriate, other key performance indicators, including information relating to environmental

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<sup>467</sup> S417 (2) CA.

<sup>468</sup> See the draft Companies Act (Strategic Report and Directors' Report) Regulations 2013 (draft Regulations). S414A of the draft Regulations requires directors to prepare a strategic report which will replace the business review. The draft Regulations are, at the time of writing, under review by Parliament. If approved, they will come into force in October 2013. See: BIS, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013).

<sup>469</sup> S417 (3) CA.

<sup>470</sup> S417 (4) CA.

matters and employee matters.<sup>471</sup> This provision in s417 (6) CA emphasises the significance of financial information as these 'must' be included, whereas other key performance indicators relating to environmental matters and employee matters only need to be included 'where appropriate'. This situation is significant for CSR as it prioritises financial issues and makes the reporting about environmental matters (which are part of the CSR agenda) optional. In addition to this effective subordination of CSR matters in s417 (6) CA, one must consider the situation in s417 (5) CA which was referred to above. The fact that this section allows quoted companies to leave out information about environmental matters, employees as well as social and community issues, as long as the company declares that its business review does not contain this information, degrades reporting about CSR to a voluntary exercise for directors. It is a clear weakness of the provision that it remains very vague about what is to be included into the business review.<sup>472</sup> Directors can make quite neutral statements due to the discretion that they have in the writing of the reports.<sup>473</sup>

Research about the question how the relationship between company boards and their investors has been affected by the business review requirements further questions the effectiveness of the new reporting requirement.<sup>474</sup> A study by Villiers and Aiyegbayo based on semi-structured interviews with key corporate governance actors, such as investor relations managers and corporate governance directors from institutional investment firms, shows that the business review makes little difference to the quality of reports.<sup>475</sup> According to Villiers and Aiyegbayo's study, companies are struggling to report effectively their non-financial key performance indicators.<sup>476</sup> As these are CSR issues such as environmental matters, this study supports the view taken in this section that the practical effect of s417 CA for the promotion of CSR is limited.

This outcome is further exacerbated by the fact that it is difficult to hold directors accountable for breaches of their reporting duty. Pursuant to s463 CA, directors are only liable for false and misleading statements or the omission of anything required

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<sup>471</sup> S417 (6) CA. 'Key performance indicators' is defined as 'factors by reference to which the development, performance or position of the company's business can be measured effectively'. However, the requirement in subsection (6) does not apply to a medium-sized company.

<sup>472</sup> J Birds et al. (eds), *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 11.6.

<sup>473</sup> C Villiers, 'Narrative reporting and enlightened shareholder value under the Companies Act 2006' in J Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 108.

<sup>474</sup> C Villiers and O Aiyegbayo, 'The enhanced business review: has it made corporate governance more effective?' (2011) *JBL* 699, 700.

<sup>475</sup> *ibid*, 712.

<sup>476</sup> *ibid*.

to be in the report under the condition that the director knew that the statement was untrue or misleading or if he was reckless as to whether it was untrue or misleading and he knew the omission to be dishonest concealment of a material fact.<sup>477</sup> This section effectively restricts liability to cases of deceit. It cannot arise in negligence which is the reason why it has been called a 'safe harbour provision'.<sup>478</sup> Moreover, the claimant is the company which can only sue in case of a loss suffered as a consequence of the false or misleading statement, something which is difficult to prove. This means that the stakeholders of the company who should benefit both from the considerations enlisted in s172 (1) CA and the reporting about the discharge of this duty are left without a remedy in cases where the directors do not report about matters of CSR at all.

### 3.4.2.2 The limitations of the business review

The business review is considered to be what accountants call 'narrative reporting'.<sup>479</sup> Narrative reporting enables managers to explain the company's performance without numbers and to indicate the future direction of the company's business.<sup>480</sup> The duty to write a business review is part of the government's intention that companies acknowledge their social responsibilities.<sup>481</sup> However, what appeared to be a rather novel idea during the work of the Company Law Steering Group in the late 1990s and early 2000s has since then to some extent been overtaken by disclosure developments outside the Companies Act. In the meantime, the pressure on companies to publicly commit themselves to CSR has led to the widespread voluntary disclosure of CSR-related activities by companies which were not foreseen at the time of the Company Law Review.<sup>482</sup> It must be added, however, that this voluntary disclosure is not necessarily very effective.<sup>483</sup> The development of voluntary disclosure outside the Companies Act further questions if the business review does contribute to the promotion of CSR.

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<sup>477</sup> Under these circumstances the director is required to compensate the company for any loss suffered as a result of the misconduct, s463 (2) CA.

<sup>478</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 16-28.

<sup>479</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 9.9.6.

<sup>480</sup> C Villiers and O Aiyegbayo, 'The enhanced business review: has it made corporate governance more effective?' (2011) *Journal of Business Law* 699, 702. See generally for a discussion of potential readers of corporate reports: C Villiers, *Corporate Reporting and Company Law* (CUP 2006) 85-92.

<sup>481</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 9-40.

<sup>482</sup> *ibid.*

<sup>483</sup> See below: Comments made to the consultation by BIS Department for Business Innovation & Skills, *Summary of responses: The future of Narrative Reporting – A consultation* (December 2010) 14, available at: <http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation> (last accessed 04/01/2013).

In this regard it is important to note that the system of narrative reporting is currently under review in the UK and likely to be subject to legislative reforms due to come into force later this year.<sup>484</sup> In 2010 the government issued a consultation paper, *The Future of Narrative Reporting*, to consult on the business review in order to enable more effective shareholder engagement.<sup>485</sup> A summary of responses document was published in December 2010.<sup>486</sup> Upon analysing the contributions, the government chose to publish a further consultation on the future of narrative reporting in September 2011. In October 2012, the government proposed changes to the system of narrative reporting in the UK and published a further document that contained draft regulations.<sup>487</sup> These will be discussed later on in this section. The background to this consultation process is that the government had committed itself to this review during the passage of the Companies Act through Parliament as the business review replaced the originally proposed Operating and Financial Review (OFR).<sup>488</sup> The main objective of the OFR was to provide 'more qualitative and forward looking reporting, in addition to information that is quantitative, historical or concerns internal company affairs'.<sup>489</sup> This abolition of the OFR was received with

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<sup>484</sup> See BIS Department for Business, Innovation and Skills, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013). The proposals will be discussed below.

<sup>485</sup> BIS Department for Business, Innovation and Skills, *The Future of Narrative Reporting: a Consultation* (August 2010), available at: <http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation> (last accessed 04/01/2013).

<sup>486</sup> BIS Department for Business Innovation & Skills, *Summary of responses: The future of Narrative Reporting – A consultation* (December 2010), available at: <http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation> (last accessed 04/01/2012).

<sup>487</sup> See BIS, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013).

<sup>488</sup> The statute requiring companies to produce an OFR was passed in March 2005. Clauses relating to the OFR were part of the Company Law Reform Bill published in early November 2005. The OFR included reporting on, inter alia, the company's purpose, strategy and principles drivers of performance; an account of the company's key relationships, with employees, customers, suppliers and others, on which such success depends; the company's environmental policies and performance, and including compliance with laws and regulations; policies and performance on community, social, ethical and reputational issues. The government then decided to abandon the OFR in late November 2005. The then Chancellor of the Exchequer Gordon Brown justified this decision with reference to the introduction of a new narrative reporting requirement, the Business Review, as part of the directors' report, as a consequence of the EU Accounts Modernisation Directive. He argued that the Business Review would include the key improvements from the OFR, yet be more flexible, and would avoid 'gold-plating' the EU Directive which would increase the regulatory burden on companies. See: K Campbell and D Vick, 'Disclosure law and the market for corporate social responsibility', in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 257 – 258.

<sup>489</sup> J Birds et al. (eds), *Boyle & Birds' Company Law* (6<sup>th</sup> edn, Jordans 2007) para 11.6.; See for an overview of the background to the introduction of the business review and the withdrawal of the OFR: A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 147 – 156. See for the Company Law Review Steering Group's reports: Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) paras 5.82 – 5.88; Company Law Review, *Modern Company Law for a Competitive Economy: Final Report* (HMSO 2001) para 8.40.

criticisms.<sup>490</sup> Johnston makes the criticism that the business review is less prescriptive than the OFR would have been and that the business review offers less guidance about its content.<sup>491</sup> Whilst he admits that ‘the success of the OFR was by no means certain’<sup>492</sup>, it would have enabled investors to gain a better understanding of the way in which individual businesses generate wealth which, in turn, would have enabled directors to exercise more discretion in their decision-making.<sup>493</sup> Moreover, the abandoned OFR would have given directors an opportunity to consider the various interests that they must have to have regard to under s172 (1) CA to an extent that is not required by the business review.<sup>494</sup>

The responses to the first consultation were mixed with positive feedback from companies and business representatives and criticisms from NGOs and Trade Unions.<sup>495</sup> The latter respondents said that company reports often failed to explain how companies were managing issues such as human rights, environmental impacts or employee matters where these had material implications for their strategy and risk management. This feedback is in line with the result above that the reporting of companies about the promotion of CSR goals is more or less left to the directors’ discretion. With regard to the question if elements of the OFR with its more prescriptive provisions should be reinstated in order to improve the quality of reporting, views were particularly divergent.<sup>496</sup> Whilst the majority of companies and business representatives negatively responded to this question, several NGOs and Trade Unions made clear that there was a need for a more precise regulatory framework which set out exactly what information was needed on social and environmental matters to help companies and users. They argued that human rights issues should be explicitly included. The critical views of the NGOs and Trade Unions reflect the conclusion of the analysis in this section that the effects of the business review on the promotion of CSR are likely to be rather limited.

Reviews from corporate reporting agencies, accounting firms and governmental regulators are critical of the quality of narrative reporting in the UK, too.<sup>497</sup> PWC, for

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<sup>490</sup> See for example: A Johnston, ‘After the OFR: Can Shareholder Value Still be Enlightened?’ (2006) *EBOLR* 817, 832.

<sup>491</sup> *ibid*, 841.

<sup>492</sup> *ibid*, 842.

<sup>493</sup> *ibid*, 833.

<sup>494</sup> *ibid*, 842.

<sup>495</sup> BIS Department for Business Innovation & Skills, *Summary of responses: The future of Narrative Reporting – A consultation* (December 2010).

<sup>496</sup> *ibid*, 20.

<sup>497</sup> Accounting Standards Boards, *Full results of a Review of Narrative Reporting by UK Listed Companies in 2008/2009* (October 2009), available at: <http://www.frc.org.uk/asb/publications/documents.cfm?cat=79>, (last accessed: 04/10/2012); Financial

example, reviews annually the narrative reporting practice of the FTSE350.<sup>498</sup> In a recent review they conclude that ‘companies still fail to present a clear, credible and coherent picture of the direction of travel and short-term performance’.<sup>499</sup> They argue that many companies would only pay lip service to their sustainability goals. This argument is evidenced by their finding that around 40% of FTSE 100 companies and around 60% to 70% of FTSE 250 companies have significant progress to make in terms of their narrative reporting regarding external drivers, risks and sustainability reporting.<sup>500</sup> In its response to the consultation on the future of narrative reporting, PWC points out that its research would show that regulation appears to have an indirect positive impact on reporting by establishing the key principles for good quality reporting.<sup>501</sup> The Accounting Standards Board, an operating body of the Financial Reporting Council (FRC), reviewed the reports of a sample of 50 listed companies.<sup>502</sup> Notably, they found out that only 20% of the companies in their sample revealed best practice in terms of their disclosure of the CSR issues concerning environmental matters, employees as well as social and community issues.<sup>503</sup> 34% were compliant in spirit whereas 40% were either not compliant with the law or were compliant but the discussion was either generic or related to matters that were unimportant to the business.<sup>504</sup> This situation reveals a lack of transparency in respect of CSR issues and further questions whether the business review in s417 CA promotes CSR at all.

It appears from the studies about narrative reporting that the business review in its current form does not meet its aims. From a CSR perspective it is a particular limitation that the information about the environment, employees, as well as social and community issues, must only be included in the business review of quoted companies ‘to the extent necessary for an understanding of the development, performance or position of the company’s business’.<sup>505</sup> This restriction is further exacerbated by the fact that quoted companies only need to state which of the

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Reporting Council, *Rising to the challenge: A review of narrative reporting by UK listed companies* (2009).

<sup>498</sup> PWC, *A snapshot of FTSE 350 reporting: Compliance mindset suppresses effective communication* (2009), available at: [www.pwc.co.uk/eng/.../a\\_snapshot\\_of\\_ftse\\_350\\_reporting.html](http://www.pwc.co.uk/eng/.../a_snapshot_of_ftse_350_reporting.html) (last accessed 04/10/2012).

<sup>499</sup> *Ibid.*

<sup>500</sup> *Ibid.*

<sup>501</sup> PWC comments on ‘The future of narrative reporting: Consulting on a new reporting framework’, Letter dated 25 November 2011, available at: [www.pwc.co.uk/.../future-of-narrative-reporting-final-pwc-comment](http://www.pwc.co.uk/.../future-of-narrative-reporting-final-pwc-comment) (last accessed 04/10/2012).

<sup>502</sup> Accounting Standards Boards, *Full results of a Review of Narrative Reporting by UK Listed Companies in 2008/2009* (October 2009), available at:

<http://www.frc.org.uk/asb/publications/documents.cfm?cat=79> (last accessed 04/10/2012).

<sup>503</sup> *Ibid.*, 23 – 25.

<sup>504</sup> *Ibid.*

<sup>505</sup> S417 (5) CA.



information about, for instance, the environment or employees, their report does not contain. The consequence is a situation where the reporting about these aspects is rather limited, as evidenced by several studies about the quality of the reports of FTSE 100 and FTSE 250 companies. These results confirm the critical assessment of Johnston about the move away from the originally planned OFR to the business review. Johnston argued that the business review was 'incapable' of playing the role that was envisaged for the OFR (i.e. informing the company's investors about the ways in which the company creates wealth, including information about social and environmental issues as well as the company's relationship with its employees, customers, suppliers and others).<sup>506</sup> The analysis of both s172 CA and the business review in this chapter support his conclusion that the UK system of corporate governance would 'remain unchanged by the company law reforms'.<sup>507</sup> Given that the quality of voluntary CSR reports of companies is also seen critically by their readers in the survey on the future of narrative reporting by BIS, it seems as if the state of reporting on CSR issues is generally poor. Keay therefore is correct in his criticisms that the decision not to require an OFR, but rather to implement the business review 'causes one to ask to what extent is the government committed to any consideration of stakeholder interests'.<sup>508</sup>

The business review is too vague and leaves too much discretion for any effective reporting on stakeholder-issues. The approach of the government to encourage business to (voluntarily) disclose their CSR policies and activities rather than to legally require them to do so has so far only produced poor results. The business review in s417 CA in its current form has therefore not greatly helped to promote CSR. It is primarily aimed at shareholders, as s417 (2) CA states that 'the purpose of the business report is to inform members of the company'. It should help shareholders understand how the directors 'have performed their duty under section 172'. This focus on shareholders is further emphasised by the prioritisation of the review of the company's business, its risk and uncertainties as well as, in the case of a quoted company, the use of financial key performance factors to describe the factors likely to affect the future development, performance and position of the business. The focus of the review is on assessing the business from an investor's perspective.<sup>509</sup> The reporting about stakeholder issues, such as the environment, is left to the discretion of the company. Whereas the review must contain financial key

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<sup>506</sup> A Johnston, 'After the OFR: Can Shareholder Value Still be Enlightened?' (2006) *EBOLR* 817, 842.

<sup>507</sup> *ibid.*

<sup>508</sup> A Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 23 *Sydney Law Review*.

<sup>509</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 259.

performance indicators, other key performance indicators pertaining, for example, to the environment or employee matters are only necessary 'where appropriate'. Stakeholder-issues are therefore effectively subordinated under financial considerations. Like the s172 (1) CA duty, the business review is firmly embedded in the goal of prioritising the interests of shareholders.<sup>510</sup> Both the duty to promote the success of the company for the benefit of its members as a whole and the business review are strongly limited in their ability to promote CSR.

### 3.4.2.3 The promotion of CSR under the proposed strategic report

As a result of the consultation process on the state of narrative reporting in the UK the government has proposed to replace the business review by a strategic report.<sup>511</sup> The proposals are, at the time of writing, considered by Parliament and are expected to come into force later in 2013. At the same time, the EU Commission has proposed amendments to existing legislation in order to improve the transparency of large companies on social and environmental matters.<sup>512</sup> The following part will focus on the proposed changes to English company law first and then review if the proposed changes by the EU Commission will necessitate changes to the system of narrative reporting in English law.

The draft Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 that the government has proposed includes the requirement for companies to produce a strategic report.<sup>513</sup> The strategic report (which will be required by s414A of the Companies Act) will replace the business review, but will be similar to it.<sup>514</sup> Under the proposed regime, the strategic report will come first in the directors' report. It will require quoted companies to report on their strategy and their business model.<sup>515</sup> Whilst the new s414C CA will 'replicate section 417 of the Companies Act 2006'<sup>516</sup>, the strategic report will also explicitly require quoted companies to report on human rights issues. This inclusion of human rights can be seen as a response

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<sup>510</sup> *ibid*, 260.

<sup>511</sup> BIS, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013).

<sup>512</sup> EU Commission, 'Commission moves to enhance business transparency on social and environmental matters' (Press Release, 16<sup>th</sup> April 2013), available at: [http://europa.eu/rapid/press-release\\_IP-13-330\\_en.htm](http://europa.eu/rapid/press-release_IP-13-330_en.htm) (last accessed: 19/05/2013).

<sup>513</sup> BIS, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), 4, available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013). The strategic report will continue to be subject to an exemption for small companies. This exemption will now be found in s414B. The reporting will also continue to be subject to the 'safe harbour' provision in s463 CA.

<sup>514</sup> *ibid*, 6.

<sup>515</sup> The FRC's UK Corporate Governance Code already requires companies to provide reporting on these issues.

<sup>516</sup> *ibid*, 6. S417 CA contains the requirements for the business review.

to the recommendation in the UN Guiding Principle on Business and Human Rights that states should ‘encourage, and where appropriate require, business enterprises to communicate how they address their human rights impacts’.<sup>517</sup> Human rights issues will be added to the social and community issues in s414C (4) (d) (iii) which will otherwise replicate s417 (5) (b) (iii) CA. Whilst the addition of human rights into the list of factors for the strategic report sounds promising from a CSR point of view at first sight, it needs to be taken into account that the same restrictions to the reporting about these issues will apply as for the existing provision: First, the quoted companies must only include information about these issues ‘to the extent necessary for an understanding of the development, performance or position of the company’s business’; secondly, if the report does not contain information about these issues (as well as environmental matters and the company’s employees) the report must only state which of those kinds of information it does not contain. A notable change under the new regime is that quoted companies will be required to disclose the number of women on the board, in senior executive positions and in the whole organisation.<sup>518</sup>

It can be concluded that the proposed strategic report is unlikely to change much in terms of CSR reporting despite of the addition of human rights into the list of factors. Directors will still not be forced to report about CSR issues. The reform of narrative reporting with the introduction of the new strategic report is therefore a missed opportunity from a CSR point of view. The duty to report about gender diversity both within the management and the company as a whole is a step into the right direction. It is hoped that this requirement will increase pressure on boards to become more diverse (which is a point that is addressed below in the section about the board).

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<sup>517</sup> Principle 3 (d) UN Guiding Principles on Business and Human Rights.

<sup>518</sup> This idea was suggested by Lord Davies in his report about women on boards in the UK. The 2012 version of the UK Corporate Governance Code requires that a separate section in the annual report section ‘should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives’. These requirements for the strategic report will be found in the new s417C (5) CA: ‘In the case of a quoted company, the strategic report must contain a breakdown showing – (a) the number of persons of each sex who are directors of the company; (b) the number of persons of each sex who are managers of the company (other than persons falling within paragraph (a)); (c) the number of persons of each sex who are employees of the company. The new S417 (6) CA adds: ‘In subsection (5), “manager” means a person who has responsibility for planning, directing or controlling the activities of the company and is an employee of the company.’

### 3.4.2.4 The proposed EU Directive on the disclosure of nonfinancial and diversity information

However, the reporting about CSR matters could be improved if the Directive regarding disclosure of nonfinancial and diversity information by certain large companies and groups that was proposed in April 2013 is to be introduced.<sup>519</sup> The background to the proposed Directive is that, in its 2011 communication on CSR, the Commission had stated its commitment to implement the UN Guiding Principles on Business and Human Rights.<sup>520</sup> In its action plan on company law and corporate governance in December 2012, the Commission announced that it would make a proposal in 2013 to strengthen disclosure requirements on board diversity policy and risk management.<sup>521</sup>

Moreover, in February 2013, the EU Parliament adopted two resolutions in which it highlights the importance of company transparency on environmental and social matters.<sup>522</sup> The EU Parliament asked the Commission to bring forward a proposal on non-financial disclosure by companies. The impact assessment of the Commission on corporate reporting on nonfinancial information showed significant weaknesses both in terms of the quantity of information and the quality of information.<sup>523</sup> The

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<sup>519</sup> European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' COM (2013) 207 final, available at: [http://ec.europa.eu/internal\\_market/accounting/docs/non-financial-reporting/com\\_2013\\_207\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf) (last accessed: 19/05/2013).

<sup>520</sup> As indicated above, principle 3 (b) of the UN Guiding Principles contains the recommendation that states should encourage, and where appropriate require, business enterprises to communicate how they address their human rights impacts'.

<sup>521</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies' COM (2012) 740 final, para 2.1, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF> (last accessed: 21/05/2013).

<sup>522</sup> The resolutions passed on 6<sup>th</sup> February are: First, Report on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth (2012/2098(INI)); Committee on Legal Affairs, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0017+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013); Secondly, Report on Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery (2012/2097(INI)); Committee on Employment and Social Affairs, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0023+0+DOC+PDF+V0//EN&language=EN> (last accessed: 19/05/2013).

<sup>523</sup> The Commission states that it is estimated that only 2500 out of the total 42000 EU large companies formally disclose non-financial information on a yearly basis. Moreover, the quality of information disclosed by companies does not adequately meet the needs of users. See: European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Council Directives amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' COM (2013) 207 final, 4, available at: [http://ec.europa.eu/internal\\_market/accounting/docs/non-financial-reporting/com\\_2013\\_207\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf) (last accessed: 20/05/2013).

proposed Directive is intended to be an amendment to the Accounting Directives rather than a new Directive.<sup>524</sup>

The proposed Directive, if introduced, would require large companies with more than 500 employees<sup>525</sup> to disclose relevant and material environmental and social information in their annual reports. The proposed Directive stipulates that the annual report of these companies must include a non-financial statement containing information relating to at least environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters. This statement must include a description of the policy pursued by the company in relation to these matters, the results of these policies and the risks related to these matters and how the company manages those risks. Companies that do not pursue policies in relation to one or more of these matters shall provide an explanation for not doing so.<sup>526</sup> Moreover, the proposed Directive also requires companies to describe their diversity policy for its administrative, management and supervisory bodies with regard to aspects such as age, gender, geographical diversity, educational and professional background, the objectives of this diversity policy, how it has been implemented and the results in the reporting period.<sup>527</sup> The 'comply or explain' approach also applies to this reporting duty.

The proposed Directive overlaps with the planned reform of narrative reporting in English law. However, the changes to English law are expected to be effective in October 2013 whereas the Commission envisages that companies would be required to publish their first reports in compliance with the Directive in 2017.<sup>528</sup> Whilst there are similarities between the two proposed regimes, it is important to note that the requirements of the Directive go further than the business review and the strategic report. First, contrary to the proposed strategic report the Directive also explicitly requires reporting on anti-corruption and bribery matters. However, whilst this issue is not explicitly required in the proposed strategic report, it could be argued that this addition will not make a real difference to the way in which English companies address bribery as they already face liability under s7 of the Bribery Act

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<sup>524</sup> *ibid*, 6.

<sup>525</sup> And who, during the financial year, exceed on their balance sheet dates either a balance sheet total of EUR 20 million or a net turnover of EUR 40 million.

<sup>526</sup> Article 1 (1) (a) of the proposed Directive.

<sup>527</sup> Article 1 (2) of the proposed Directive.

<sup>528</sup> European Commission, 'Disclosure of non-financial and diversity information by certain large companies and groups (proposal to amend Accounting Directives) - Frequently asked questions' (16th April 2013), available at: [http://europa.eu/rapid/press-release\\_MEMO-13-336\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-336_en.htm) (last accessed: 20/05/2013).

2010.<sup>529</sup> They can therefore be expected to take bribery seriously.<sup>530</sup> Secondly, rather than just requiring companies to report on CSR issues 'to the extent necessary for an understanding of the development, performance of position of the company's business (the position under the strategic report), the proposed Directive prescribes reporting of the policies, their results and risks whenever a company has a policy on these issues. Where a company does not have such a policy, it would need to give reasons for this situation, which applies the 'comply or explain' approach (that underlies the UK Corporate Governance Code) to CSR reporting. In contrast, the strategic report would allow companies purely to state that they did not report on these issues. Therefore, the requirements of the proposed Directive go beyond the current and proposed reporting system under the Companies Act. If introduced, the Directive would therefore improve the reporting on CSR by large companies.<sup>531</sup> Thirdly, the diversity reporting under the directive, too, goes beyond the planned changes in the reporting duty under the Companies Act. Therefore, the proposed directive has potential to improve the status quo of corporate CSR reporting in English law. Besides, as CSR is by its nature an international concern, it is a positive development if there is a level playing field for companies throughout the EU. The Directive is unlikely to make CSR reporting a primary concern for companies, but it will nevertheless improve the kinds of information that companies need to provide on their socially responsible conduct. Whilst the reporting duty will not force companies to adopt CSR policies, it will nevertheless put the reporting on these matters on a comparable ground throughout the EU. Moreover, it will enable the public to identify those companies that do not have a CSR policy. The important issue that remains to be seen, however, will be the quality of reporting under the new reporting scheme with its continuance of the 'comply or explain' approach. The key issue for the success of the proposed reporting regime will be if companies use

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<sup>529</sup> S7 Bribery Act 2010: 'Failure of commercial organisations to prevent bribery'. Under this section a commercial organisation is guilty of an offence of bribery if a person associated with it bribes another person. Pursuant to s8 the associated person can, for example, be an employee, agent or subsidiary.

<sup>530</sup> See the analysis of supply chain contracts in chapter 4 (contract law) and of codes of conduct in chapter 5 (consumer law).

<sup>531</sup> The proposed Directive emphasises that in fulfilling their reporting duty under this directive companies may rely on national frameworks, EU-based frameworks and international frameworks such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN "Protect, Respect and Remedy" Framework, the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisation (ISO) 26000, the International Labour Organization (ILO) Tripartite Declaration of principles concerning multinational enterprises and social policy, and the Global Reporting Initiative. It is therefore intended to align CSR reporting under existing frameworks with the requirements of the directive so that companies that already disclose CSR matters under existing frameworks do not repeat the reporting exercise. The proposed Directive exempts companies from the reporting duty under the Directive if they prepare a comprehensive report on CSR issues that address all the issues required under the Directive relying on national, EU-based or international frameworks. This rule ensures that companies that already follow a CSR reporting framework will not be disadvantaged by having to repeat the same information.

it as a genuine opportunity to reflect on their CSR policies and as an instrument to inform their investors as well as other stakeholders or if companies only provide boilerplate statements. In the end, the reporting duty will only be one (albeit important) tool for the promotion of CSR. The following section will analyse to what extent the investors, who are one of the key addressees of the reporting duty, can contribute to the socially responsible conduct of companies.<sup>532</sup>

### 3.4.3 Shareholders' engagement and the derivative action

It is said that good corporate governance depends on both effective shareholder control and an effective board (to be discussed below).<sup>533</sup> This section will analyse to what extent shareholders can contribute to the promotion of CSR within companies. The focus will be on two aspects: First, the role of institutional investors as they are a powerful group of shareholders who have potential to influence the decision-making of companies. Secondly, the focus will be on the use of the derivative action pursuant to s260 (1) CA as a means to enforce CSR.

#### 3.4.3.1 Institutional investors

Several reviews of corporate governance have emphasised the importance of institutional investors for the monitoring of the directors.<sup>534</sup> The reason for this focus on institutional investors is that they hold approximately 40 per cent of the shares of quoted companies in the UK.<sup>535</sup> Due to this power, discussions about corporate governance commonly focus on the ability of institutional investors to monitor and engage with decisions of the board. Shareholder activism is an aspect that deserves consideration in a chapter on the promotion of CSR in company law and corporate governance as shareholders can influence the adherence of a company to social issues.<sup>536</sup>

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<sup>532</sup> European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' COM (2013) 207 final, 2, available at: [http://ec.europa.eu/internal\\_market/accounting/docs/non-financial-reporting/com\\_2013\\_207\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf) (last accessed: 19/05/2013).

<sup>533</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 5-43.

<sup>534</sup> See for example Paul Myners, *Institutional Investment in the UK: A Review (the Myners Report)* 2001; Company Law Review, *The White Paper: Modernising Company Law* (DTI 2002, Cm 5553-I and Cm 5553-II) paras 2.43-2.44; Walker, *A review of corporate governance in UK banks and other financial industry entities, Final recommendations* (November 2009).

<sup>535</sup> Institutional shareholders accounted for 39.9 per cent of the UK ordinary shares at 31 December 2008 with a combined value of £462.4 billion. Of these, the largest holders were insurance companies (£154.9 billion) and pension funds (£148.8 billion). It must be noted that the share ownership is less homogenous than it was in the past as investors from outside the UK owned 41.5 per cent of UK shares listed on the UK Stock Exchange. See Office for National Statistics, *Share Ownership Survey 2008*, available at: <http://www.ons.gov.uk/ons/rel/pnfc1/share-ownership---share-register-survey-report/2008/index.html> (last accessed 16/02/2012).

<sup>536</sup> D Millon, 'Shareholder Social Responsibility' (2013) 36 *Seattle University Law Review* 911.

However, the different reviews of institutional investors concur in their critical assessment of the status quo, i.e. the inadequate level of engagement of institutional investors with their investee companies.<sup>537</sup> And, notably, the criticisms repeat themselves. In 2001, the White Paper on the company law reform emphasised that a change in the ‘traditional’ attitude of institutional investors towards the companies in their portfolios was necessary.<sup>538</sup> The ‘traditional’ attitude was understood as a lack of engagement with their portfolio companies, a focus on short-term financial gains and the widespread use of an exit strategy (i.e. selling of the shares) in case the investors were unhappy about the direction of the company.<sup>539</sup> At the same time the White Paper positively commented on the *Statement of Principles on the Responsibilities of Institutional Investors*, published by the Institutional Shareholders Committee as a means to improve the role of institutional investors.<sup>540</sup> This document contains statements of best practice for institutional investors about their monitoring duties.<sup>541</sup> It also declares that the primary role of institutional investors is that of investors. In the wake of the financial and economic crisis, the role of institutional investors continued to be a matter of concern, however. The 2009 Walker Review of corporate governance in UK banks devotes a whole chapter to the issue of the effective engagement of institutional investors with their portfolio companies.<sup>542</sup>

The discussions about the role of institutional investors eventually led to the development of the UK Stewardship Code in 2010.<sup>543</sup> The UK Stewardship Code was revised in September 2012.<sup>544</sup> It is a set of principles which ‘aims to enhance the quality of engagement between institutional investors and companies’.<sup>545</sup> It is

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<sup>537</sup> See Company Law Review, *The White Paper: Modernising Company Law* (DTI 2002, Cm 5553-I and Cm 5553-II) 36.

<sup>538</sup> *ibid.*

<sup>539</sup> *ibid.*

<sup>540</sup> Institutional Shareholders Committee, *Statement of Principles on the Responsibilities of Institutional Investors* (updated June 2007). The Institutional Shareholders Committee (renamed in 2011 as the Institutional Investor Committee) is a group of trade associations that represent institutional investors and comprises the Association of British Insurers, the Investment Management Association and the National Association of Pension Funds. The Statement of Principles has now been developed into a Code on the Responsibilities of Institutional Investors. The White Paper stated about institutional investors: ‘There are, however, some signs that the institutional investors realise that there should be a change’, see White Paper, 36.

<sup>541</sup> *ibid.*

<sup>542</sup> Walker, *A review of corporate governance in UK banks and other financial industry entities, Final recommendations* (November 2009) chapter 5.

<sup>543</sup> Financial Reporting Council, *The UK Stewardship Code* (July 2010), available at: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/The-UK-Stewardship-Code.aspx> (last accessed 20/05/2013).

<sup>544</sup> Financial Reporting Council, *The UK Stewardship Code* (September 2012), available at: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.aspx> (last accessed: 20/05/2013).

<sup>545</sup> Preface of the 2010 version of the UK Stewardship Code. It is stated in the UK Stewardship Code that its origins lie in the Statement of Principles on the Responsibilities of Institutional Investors by the ISC which have since become a code, see *ibid.*, 2.



addressed 'in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in UK listed companies'.<sup>546</sup> Asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles.<sup>547</sup> Stewardship includes monitoring and engaging with companies on matters such as strategy, performance, risk and corporate governance, including culture and remuneration.<sup>548</sup> The UK Stewardship Code follows the 'comply or explain' approach of the UK Corporate Governance Code which means that investors who do not comply with provisions of the UK Stewardship Code shall explain that they have not done so and give reasons for this.<sup>549</sup> The UK Stewardship Code provides inter alia that institutional investors should monitor their investee companies, report about how they discharge this duty and that they should seek to exercise their voting rights. Principle 2 clarifies that it is the duty of institutional investors to act in the interests of their clients.<sup>550</sup> As part of their duty to monitor their investee companies (Principle 3), institutional investors should 'satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members'. Principle 4 has undergone a slight change in the revision of the Stewardship Code. Whereas the 2010 version stipulated that the institutional investors should have 'clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value', the revised version omits the reference to the protection and enhancement of 'shareholder value'.<sup>551</sup> Moreover, the guidance to this principle also outlines that companies may want to intervene when they have concerns about the company's approach to risks that may arise from social and environmental matters.<sup>552</sup>

The effects of the UK Stewardship Code in terms of promoting CSR in investee companies are likely to be limited, however. Although the term 'stewardship' in the title appears to emphasise the responsibility of institutional investors, there is not much in the Code that is new at all. The duty to monitor investee companies is nothing new, in light of the guidelines previously published by the Institutional

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<sup>546</sup> FRC, The UK Stewardship Code (September 2012), 'Application of the Code', 2.

<sup>547</sup> *ibid.*, 'Stewardship and the Code', 1.

<sup>548</sup> *ibid.*

<sup>549</sup> *ibid.*, 'Comply or explain', 4.

<sup>550</sup> *ibid.*, Principle 2 Guidance.

<sup>551</sup> In the 2010 UK Stewardship Code Principle 4 reads: 'Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.' The same principle in the 2012 UK Stewardship Code reads: 'Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.'

<sup>552</sup> The UK Stewardship Code (September 2012), Principle 4, Guidance.

Shareholders Committee.<sup>553</sup> In fact, there is a considerable continuity between the UK Stewardship Code and the previous documents by the Institutional Shareholders Committee.<sup>554</sup> The fact that the 2010 version of the UK Stewardship Code even explicitly referred to 'enhancing shareholder value' is not a problem for CSR in itself, given that investors expect a financial return on their investment. However, the explicit absence of references to the pursuit of CSR goals shows that the UK Stewardship Code does not mark a step towards the promotion of CSR. The comment in the guidance to principle 4, that the instances in which investors 'may want to intervene' include those 'that may arise from social and environmental matters', is rather vague. The absence of a principle with an express outline of CSR issues in the Stewardship Code is particularly disappointing, given that the new duty in s172 (1) CA refers to the interests of various stakeholders. This duty has not had any impact on these best practice guidelines for institutional investors. It is therefore not to be expected that the majority of institutional investors are promoting these interests as part of their shareholder engagement which means that the impact of the UK Stewardship Code for CSR is likely to be minimal.

On a practical note, it is important to consider that the overall share ownership of traditional institutional investors, such as insurance companies and pension funds (with a potentially higher interest in long-term success), is declining whereas that of hedge funds and overseas investors is increasing (there is a danger that these groups are less interested in the long-term success of their investee companies or CSR issues).<sup>555</sup> The scepticism about the restricted ability of institutional investors to enhance greater CSR is also based on the fact that the division of power generally vests the power of management in the board of directors with only limited rights retained by the shareholders such as the statutory right to amend the articles<sup>556</sup>, to reduce the share capital<sup>557</sup> and to remove the directors<sup>558</sup>. At the moment, shareholders do not have much power to promote greater CSR in their investee

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<sup>553</sup> See for a discussion of the relationship between 'The UK Stewardship Code' and the 'Code on the Responsibilities of Institutional Investors' produced by the Institutional Investor Committee: A Reisberg, 'The notion of stewardship from a company law perspective: Re-defined and re-assessed in light of the recent financial crisis?' (2011) 18 *Journal of Financial Crime* 126, 133.

<sup>554</sup> R Tomasic, 'Towards a new corporate governance after the global financial crisis' (2011) *ICCLR* 237, 249.

<sup>555</sup> Tomasic and Akinbami point out that the fact that foreign institutions will not be subject to the Code is a potential constraint on shareholder activism, see: R Tomasic and F Akinbami, 'Shareholder activism and litigation against UK banks – the limits of company law and the desperate resort to human rights claims?' in J Loughrey, *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 151.

<sup>556</sup> S21 CA.

<sup>557</sup> SS617-619 CA.

<sup>558</sup> S168 CA. See also B Hannigan, *Company Law* (3rd edn, OUP 2012) para 8-6.

companies.<sup>559</sup> This sceptical assessment is further supported by the fact that the so-called ‘shareholder spring’ in 2012 focussed on directors’ remuneration.<sup>560</sup> Whilst there was an intensive coverage in the press about the refusal of some institutional investors to accept the remuneration reports of some companies (shareholders have an advisory vote on the directors’ remuneration report<sup>561</sup>), the engagement of the investors did not expand to CSR matters such as the quality of corporate reports on CSR or their CSR record generally.<sup>562</sup> One also needs to consider that institutional shareholders such as pension funds are under pressure to pursue short-term investment strategies in order to meet their own ongoing contractual obligations.<sup>563</sup> Moreover, the fact that investment funds are required to ensure sufficient profitability in order to remain competitive on the market further encourages short-term investment strategies.<sup>564</sup> In turn, such short-term investment strategies influence the way how directors run their companies, often leading to the prioritisation of ‘short-term earnings at the expense of potentially greater long-run firm value’.<sup>565</sup>

In summary, the contribution which institutional investors, within the framework of the UK Stewardship Code, can make to the promotion of CSR in their investee companies is limited. Whilst the UK Stewardship Code further encourages

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<sup>559</sup> The Regulatory Reform Act 2013 (the “Act”) changes the system of directors’ remuneration. Under the new regime, quoted company’s remuneration policy must be approved by an ordinary resolution of its shareholders every three years. See: <http://services.parliament.uk/bills/2012-13/enterpriseandregulatoryreform.html> (last accessed: 21/05/2013). The European Commission has also announced in its 2012 action plan on company law and corporate governance to propose a modification of the shareholders’ rights Directive in 2013 in order to improve transparency on remuneration policies and individual remuneration of directors as well as grant shareholders the right to vote on remuneration policy and the remuneration report, see: European Commission, ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies’ COM (2012) 740 final, para 3.1, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF> (last accessed: 21/05/2013).

<sup>560</sup> See for example: Financial Times, ‘Boards wake up to a shareholder spring’ (4th May 2012), available at: <http://www.ft.com/cms/s/0/a284e414-95ee-11e1-a163-00144feab49a.html#axzz2Ts5cY15i> (last accessed: 20/05/2013). The article refers to the examples of Aviva whose investors refused to approve of its remuneration report as well as Barclays which experienced almost a 33% disapproval of its remuneration report. The remuneration report is subject to shareholder approval, but the shareholders are only entitled to an advisory vote. They cannot reject the remuneration itself.

<sup>561</sup> S439 CA.

<sup>562</sup> Moreover, the existence of a ‘shareholder spring’ has been questioned on the basis of statistic evidence which revealed that despite some public disapprovals of directors’ remuneration reports the overall level of dissent in all votes on remuneration was though higher than in 2011 lower than in 2002 and 2003, see: BBC News, ‘The myth of a shareholder spring’ (12th June 2012), available at: <http://www.bbc.co.uk/news/business-18407587> (last accessed: 20/05/2013).

<sup>563</sup> Millon highlights that pension funds which are commonly perceived of as being long-term investors need to make sufficient returns on investment in order to meet their ongoing contractual obligations on a monthly basis. This need for cash is a driving force behind the reality of pursuing short-term investment strategies. Historically, public pension funds have assumed an annual return on investment rate of about 8%. See for a discussion of the issue: D Millon, ‘Shareholder Social Responsibility’ (2013) 36 *Seattle University Law Review* 911, 930-934.

<sup>564</sup> *ibid*, 934–937.

<sup>565</sup> *ibid*, 939.

institutional investors to fulfil their role to monitor their investee companies, it is unlikely to enhance greater social responsibility of companies.

### **3.4.3.2 The derivative action**

Within the context of shareholder engagement, it is important to consider the derivative action pursuant to s260 CA as a possible means to promote CSR.<sup>566</sup>

#### **3.4.3.2.1 Analysis of the statutory derivative action**

The derivative action is a claim brought by a member of the company in respect of a cause of action vested in the company and seeking relief on behalf of the company.<sup>567</sup> Pursuant to s260 (3) CA, a derivative claim may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. This section further stipulates that a derivative claim may be against the director or another person (or both). The fact that a derivative action can be brought for breach of duty by a director is important for this chapter as it brings breaches of s172 (1) CA into the ambit of the derivative claim.

Still, shareholders cannot initiate an action on behalf of the company that easily. They must apply to the court for permission to continue their claim<sup>568</sup> and they must pass a two-stage test. First, they must make a prima facie case; otherwise the court must dismiss the claim.<sup>569</sup> The second stage contains a non-exhaustive list of factors a judge must consider. S263 (2) CA contains a list of situations in which a court must refuse permission to continue with the derivative claim. According to this list, a court must refuse permission if it is satisfied that a person acting in accordance with s172 CA would not seek to continue the claim. Moreover, actual authorisation or ratification provides a complete defence to a derivative claim.<sup>570</sup> This authorisation may be done by the shareholders or by the directors. Pursuant to s239 (7) CA, the ratification of acts of directors does not affect any rule of law as to acts which are incapable of being ratified by a company. However, in fact, many breaches of duty by directors are ratifiable.

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<sup>566</sup> The other main remedy for shareholders is the unfairly prejudicial conduct remedy pursuant to s994 CA. However, this remedy is unlikely to be relevant in terms of promoting CSR, as it is predominately brought by members in private limited company who seek relief (in the form of obtaining an order that their shares must be bought by the respondents at a fair price) on the basis that the company's affairs have been conducted in a manner that was unfairly prejudicial to his interests. The remedy is therefore primarily used to obtain relief for the claimant whereas the derivative action (ss260 CA) that is analysed in this section is brought by a member of the company who seeks relief on behalf of the company, s260 (1) CA.

<sup>567</sup> S260 (1) CA.

<sup>568</sup> S261 (1) CA.

<sup>569</sup> S261 (2) CA.

<sup>570</sup> S263 (2) (b), (c) CA.

If none of the factors in s262 (2) CA apply, then the court has discretion to allow a claim to proceed.<sup>571</sup> S263 (3) CA provides guidance for the court's decision whether or not to grant permission to continue with the claim. According to s263 (3) (a) CA, the court must take into account whether the member is acting in good faith in seeking to continue the claim and pursuant to s 263 (3) (b) CA, the court must consider the importance a person acting in accordance with s172 CA (duty to promote the success of the company) would attach to continuing it. S172 (1) CA also plays a role in the list of reasons for refusing permission to continue with the claim, as s263 (2) (a) CA stipulates that a court must refuse permission if it is satisfied that a director acting in accordance with s172 (1) CA would not seek to continue the claim. This condition attaches importance to the views of a hypothetical director with regard to s172 (1) CA.<sup>572</sup> In considering whether to give permission, the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.<sup>573</sup>

In terms of the ability of the derivative action to enforce CSR, two of the conditions outlined deserve particular attention: First, breaches of directors' duties are a cause of action for a derivative action. This means that shareholders can bring a derivative action on grounds of alleged violations of CSR principles as these overlap with the list of factors in s172 CA, as shown above. Secondly, when the courts decide whether or not to grant permission to continue with the claim they must consider the importance a person acting in accordance with s172 CA would attach to it. This means that issues of CSR which are inherent in s172 CA can play a role in the way in which the courts assess the question whether or not to allow the shareholder to continue with their action.

The important question is if this new derivative action has a positive impact on pursuing CSR goals. One might assume that it does, considering the fact that, when the new statutory action was introduced, concerns were raised by business representatives that shareholder activists might overly use this new claim to challenge business actions on grounds of an alleged breach of the s172 CA duty.<sup>574</sup> It was argued then that a shareholder might, for example, challenge business

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<sup>571</sup> Hannigan argues that there is only limited scope for dismissing a claim under s263 (2) CA. In her view there will, in most cases, be no basis on which to dismiss the claim under s263 (2) CA. The consequence is that the court will then turn to s263 (3) CA for its decision whether or not to permit the claimant to continue with the claim, B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-37.

<sup>572</sup> E C Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) *Company Lawyer* 99, 100.

<sup>573</sup> S263 (4) CA.

<sup>574</sup> See B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-8.

decisions through a derivative action based on the claim that the directors did not have regard to the impact of the business decision on the community and the environment.<sup>575</sup> Adeyeye opines that corporate governance, as the part of company law which addresses the governance of companies, would be able to address CSR issues concerning both internal and external stakeholders through the use of derivative suits.<sup>576</sup> Internal stakeholders refer to those stakeholders inside the company (such as employees) and external stakeholders to those outside the company (e.g. human rights considerations, the environment and the community).<sup>577</sup> In Adeyeye's view such claims can be used to enforce ethical behaviour of companies.<sup>578</sup> There is a significant overlap between the goals of CSR and the issues which Adeyeye considers to be potentially enforceable through derivative actions. In order to find out if Adeyeye's optimistic outlook on the derivative action to promote CSR is justified, the case law will be considered. However, there is only very limited case law in this area so far which gives rise to doubts if this new cause of action does make a difference from a CSR point of view, given that the Companies Act came fully into force on 1 October 2007.

#### **3.4.3.2.2 Case law about the derivative action**

The key question is how the courts will exercise their discretion whether or not to give permission to continue with the claim. Effectively, the courts need to decide if they should interfere with the decision of the board not to pursue the claim in the first place. This possibility potentially conflicts with the traditional reluctance of courts not to second-guess business decisions.<sup>579</sup> In *Franbar Holdings Ltd v Patel* the judge identified some reasons which a hypothetical director acting in accordance with s172 (1) CA would take into account when assessing the importance of continuing the claim.<sup>580</sup> These include: the prospect of the success of the claim, the ability of the company to make a recovery on any award of damages, the disruption which would be caused on the development of the company's business by having to concentrate on the proceedings, the costs of the proceedings and any damage to the company's reputation and business if the proceedings were to fail.<sup>581</sup> Notably, none of these factors refers to the interests of the stakeholders contained in the list

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<sup>575</sup> S172 (1) (d) CA. See B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-8.

<sup>576</sup> A Adeyeye, 'The limitations of corporate governance in the CSR agenda' (2010) *Company Lawyer* 114, 117.

<sup>577</sup> D Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) *Company Lawyer* 76, 80; See generally: E Sternberg, "The defects of stakeholder theory" (1997) 5 *Corporate Governance* 3, 4.

<sup>578</sup> A Adeyeye, 'The limitations of corporate governance in the CSR agenda' (2010) *Company Lawyer* 114, 117.

<sup>579</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-56.

<sup>580</sup> [2008] B.C.C. 885 (Ch); [2008] EWHC 1534 (Ch).

<sup>581</sup> *ibid*, [36].

of factors in s172 (1) CA. Instead, the factors mentioned by the court in *Franbar* about the assessment of the claim in light of s172 (1) CA are about financial considerations. Further factors were established in the subsequent decision in *Iesini v Westrip Holdings Ltd* which again focused on financial aspects.<sup>582</sup> The judge pointed out that the weighing of the considerations was ‘essentially a commercial decision’.<sup>583</sup> However, he also stated that s172 CA would only be used as a bar to derivative claims pursuant to s263 (2) (a) CA where the court is satisfied that no director acting in accordance with s172 CA would seek to continue the claim.<sup>584</sup> If some directors would, and others would not, seek to continue the claim, the case is one for the application of s263 (3) (b) CA.<sup>585</sup> Despite this slightly optimistic comment, the existing case law suggests that the decision about whether or not to permit continuation of the derivative claim is primarily based on financial concerns despite the fact that the yardstick for this decision, s172 (1) CA, requires directors to include the interests of various stakeholders into their decisions. The use of s172 (1) CA by the courts in this assessment of derivative claims is therefore firmly embedded in the goal of maximising shareholder value.

This pessimistic outcome from a CSR point of view is further exacerbated by the case *Stimpson v Southern Landlords Association*.<sup>586</sup> Here the court refused the application as it held that a hypothetical director acting in accordance with s172 CA would not continue the action. The significant aspect of the decision for this chapter is that the court held that it had to take into account the effect of the proposed actions on the former employees of the first defendant and that this was possible as the list in s263 (3) CA is non-exhaustive.<sup>587</sup> It therefore saw the effect on employees to be a consideration which is not part of the factors enlisted in s263 (3) CA, despite the explicit inclusion of s172 (1) CA with its referral to the interests of employees into s263 (3) (b) CA. This approach therefore separates the interests of employees and s263 (3) (b) CA although this section explicitly refers to s172 CA which, in turn, contains a list of factors including employees, the environment and the community.

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<sup>582</sup> [2009] EWHC 2526 (Ch). The factors mentioned by the court are: ‘The size of the claim; the strength of the claim; the cost of the proceedings; the company’s ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay its own costs and the defendant’s as well; any disruption to the company’s activities while the claim was pursued; whether the prosecution of the claim would damage the company in other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on.’

<sup>583</sup> *ibid.*

<sup>584</sup> *Ibid.*, at [86]. The judge agreed with the decision in *Franbar* in this respect.

<sup>585</sup> Pursuant to s 263 (3) (b) CA, in considering whether to give permission (or leave) to continue the derivative claim, the court must consider the importance a person acting in accordance with s172 CA (duty to promote the success of the company) would attach to continuing the claim.

<sup>586</sup> *Stimpson v Southern Landlords Association* [2009] EWHC 2072 (Ch), [2010] B.C.C. [387]

<sup>587</sup> *ibid.*, [387], [402].

Gibbs therefore argues that the separation between s263 (3) CA, with its reference to s172 CA and employees, could put CSR merely at the discretion of the court when considering whether or not to allow a derivative claim to be further pursued.<sup>588</sup> When considering s172 CA through s263 (3) CA, the courts might then only assess it in terms of benefiting members as a whole, i.e. the majority.<sup>589</sup> This assessment would then leave out the list of factors contained in s172 (1) CA with its overlap with CSR issues from necessary considerations in s263 (3) CA. This situation means that insofar as the decision whether or not to permit a claim to be continued according to s263 CA is concerned, the courts seem to interpret s172 (1) CA as only focusing on shareholder value. The interests of the stakeholders contained in the list of the factors of the provision are left out of this approach. Courts can still include these considerations as in *Stimpson* with reference to the non-exhaustive nature of the s263 (3) CA, but this severely limits the importance of these interests.

It might be that the rationale behind this approach is that allowing shareholders to decide via derivative actions which stakeholders to consider in the decision-making process would conflict with the rule that it is up to the majority of board members to make a decision.<sup>590</sup> The fact that employees as stakeholders which are internal to the company were taken into account by the court (though as a non-exhaustive aspect) might indicate that stakeholder interests internal to the company can form part of the test pursuant to s263 (3) CA. Gibbs therefore considers it more likely that stakeholder interests external to the company such as human rights, environment and the community are dismissed.<sup>591</sup> This situation contradicts Adeyeye's opinion who anticipated successful actions on the basis of these issues. *Stimpson* therefore further demonstrates that CSR does not play an important role insofar as the decision of the courts whether or not to permit derivative claims to be continued is concerned. This decision will effectively be a commercial decision. In line with this approach, the judge based his decision to refuse the application to continue the claim in *Stimpson* also on financial considerations, as the court held that a hypothetical director acting in accordance with the s172 CA duty would not seek to continue the claim because the value of the claim was modest in reality.<sup>592</sup> The distinction between s172 (1) CA and the interests of employees in this case, as well as the emphasis on financial considerations, severely reduces the potential of the derivative claim for CSR goals.

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<sup>588</sup> D Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) *Company Lawyer* 76, 80.

<sup>589</sup> *ibid.*

<sup>590</sup> *ibid.*

<sup>591</sup> *ibid.*

<sup>592</sup> *Stimpson v Southern Landlords Association* [2010] B.C.C. [387], [389].



### 3.4.3.2.3 The effect of the derivative action for CSR

This situation questions the ability of shareholders to use the derivative action to pursue CSR aims. This negative outcome for CSR is further exacerbated by the difficulty with successfully basing claims that directors have not sufficiently paid regard to CSR on s172 (1) CA. One can therefore conclude that the scope for the derivative action to be used to enforce CSR through alleged breaches of s172 (1) CA is very limited. The analysis here supports Keay's sceptical outlook on the impact of the new derivative action as he had expected such claims to be used in few situations only, for example in case of a member who had invested in a company to pursue long-term gains, but where the directors are purely acting in the interest of short-term gains.<sup>593</sup> Even this idea seems questionable, given that s172 (1) CA gives much power to the directors to decide in a manner that they consider, in good faith, would be most likely to promote the success of the company. Further possible scenarios for Keay were derivative actions brought by employees who are also shareholders and who feel that the position of the employees has not been sufficiently included in the decision-making process or members who live in the local community and who fear that the community could be negatively affected by the impact of the corporation's work.<sup>594</sup> However, following the court's assessment of the derivative action in the *Stimpson* case, with its optional reference to employees, it is doubtful if such claims would be successful. First, even though these issues were not ruled out by *Stimpson* to be part of the court's considerations according to s263 (3) CA, it remains to be seen if they would actually be included. Secondly, even if such CSR considerations are included, the challenge remains to prove a breach of the duty in s172 (1) CA in the first place.

The discussion in this section shows that the concerns raised by business representatives at the time the Companies Act 2006 was drafted that the combination of the new duty in s172 (1) CA and the statutory derivative action could lead to litigation about business decisions (referred to as 'judicial review of a commercial decision')<sup>595</sup> seem to be unfounded so far. Quite the reverse, from a CSR perspective, the outcome is disappointing. The analysis in this section therefore confirms doubts which have been raised about the practical impact of the new derivative action in terms of promoting CSR goals.<sup>596</sup> In fact, the government

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<sup>593</sup> A Keay, 'Section 172 (1) of the Companies Act 2006: an interpretation and assessment (2007) *Company Lawyer* 106, 109.

<sup>594</sup> *ibid.*

<sup>595</sup> See for further discussion: B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) paras 9-35, 18-8.

<sup>596</sup> See for example: A Keay, 'Section 172 (1) of the Companies Act 2006: an interpretation and assessment (2007) *Company Lawyer* 106, 109.

had not anticipated a significant increase of derivative actions through the new statutory remedy.<sup>597</sup> The derivative action in its current form with the limitations (the two-stage test of the court to decide whether or not to give permission to continue the derivative claim) was intended to strike a balance between protecting the rights of shareholders on the one hand and leaving directors free to take business decisions in good faith on the other hand.<sup>598</sup> The traditional approach to shareholders' remedies that it is the company that is the proper person to sue (also known as the rule in *Foss v Harbottle*<sup>599</sup>) underlay the Parliamentary debates about the derivative action.<sup>600</sup> This rule is also based on the idea of majority rule.<sup>601</sup> Courts traditionally do not want to second-guess business decisions.<sup>602</sup> Although the rule in *Foss v Harbottle* was replaced with the statutory derivative action in the Companies Act 2006, its underlying principles are still relevant for the court's reluctance towards getting involved in business disputes as the position remains that the proper plaintiff in respect of a wrong done to a company is prima facie the company.<sup>603</sup> As this approach seems to continue to prevail in relation to shareholders' actions, there is not much to be expected from the derivative claim in terms of promoting CSR.

This analysis therefore agrees with Gibbs' argument that the new statutory derivative action does not appear 'to have altered tremendously for now'.<sup>604</sup> It is rather unlikely that the number of cases based on derivative actions is going to increase in the future.<sup>605</sup> The potential of shareholders' remedies to promote CSR is therefore limited.

#### **3.4.4 The role of non-executive directors and the composition of the board**

So far, the analysis of s172 (1) CA, the business review and the derivative action has shown that these instruments only have a limited effect on the promotion of

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<sup>597</sup> See 679 HL Official Report (5th series), cols GC4-5, 27 February 2006; 681 HL Official Report (5<sup>th</sup> series), col 883, 9 May 2006; HC Official Report, SC D (Company Law Reform Bill), 13 July 2006, cols 664-6.

<sup>598</sup> 681 HL Official Report (5th series), col883, 9 May 2006.

<sup>599</sup> *Foss v Harbottle* (1843) 2 Hare 461.

<sup>600</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 18-11.

<sup>601</sup> *ibid*, para 18-14.

<sup>602</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 18.3.3.

<sup>603</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) paras 18-12 to 18-15.

<sup>604</sup> D Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) *Company Lawyer* 76, 82. See also the analysis of shareholder litigation by Tomasic and Akinbami who conclude that 'the prospects of successful litigation against directors of large public companies, such as directors of failed UK banks and financial institutions, are somewhat remote', see: R Tomasic and F Akinbami, 'Shareholder activism and litigation against UK banks – the limits of company law and the desperate resort to human rights claims?' in J Loughrey, *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 172.

<sup>605</sup> E C Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection' (2012) *Company Lawyer* 99, 100, 106.

CSR. This situation is exacerbated by the finding of a study by BIS that most directors continue to make decisions in the same way as they had done prior to the enactment of the Companies Act 2006 despite the new duty in s172 (1) CA.<sup>606</sup> Given the discretionary power that is vested into directors in their decision-making process, it is argued here that the board is likely to be the most effective means to promote greater CSR in companies. The following part of the chapter will therefore address two issues that are particularly relevant for the promotion of CSR in the boardroom: First, the role of non-executive directors and secondly the composition of the board.

#### **3.4.4.1 The role of non-executive directors**

Boards commonly consist of both executive directors and non-executive directors.<sup>607</sup> The difference between the two is that executive directors tend to devote their whole working time to the company whereas non-executive directors usually only spend part of their working time on the company and receive a smaller director's fee than their counterparts.<sup>608</sup> Non-executive directors are often considered to be an effective means to ensure that the executive directors work in the interest of the company.<sup>609</sup> The UK Corporate Governance Code addresses the composition and the role of the board by stipulating that 'every company should be headed by an effective board which is collectively responsible for the long-term success of the company'.<sup>610</sup> The Code further requires the company to have 'an appropriate combination' of executive and non-executive directors, in particular independent non-executive directors.<sup>611</sup> The function of non-executive directors is specified by principle A 4 of the Code. It is their function to challenge the management and to contribute to the development of strategic proposals. One of the independent non-executive directors should be appointed as senior independent director to act as intermediary for the other directors.<sup>612</sup> The role of this director is 'to provide a sounding board for the

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<sup>606</sup> BIS Department for Business, Innovation and Skills, *Evaluation of the Companies Act 2006, Volume One* (2010), p 72.

<sup>607</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-2012) para 15.2.3.

<sup>608</sup> *ibid.*

<sup>609</sup> *ibid.*

<sup>610</sup> UK Corporate Governance Code, Section A: Leadership. The UK Corporate Governance Code was issued by the Financial Reporting Council in June 2010. The new edition of the Code was published in September 2012 and applies to reporting periods beginning on or 1 October 2012. The Code applies to premium listed companies and replaces the Combined Code on Corporate Governance. The Code contains standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. Listed companies are required to report on how they have applied the main principles of the Code. They must confirm if they have complied with the Code's provisions. If they have not, they must provide an explanation for this (this is known as the 'comply or explain' system. For more information see The UK Corporate Governance Code (September 2012), available at: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx> (last accessed: 20/05/2013).

<sup>611</sup> UK Corporate Governance Code, B 1: The Composition of the Board, Supporting Principles.

<sup>612</sup> UK Corporate Governance Code, A 4: Non-executive directors.

chairman and to serve as an intermediary for the other directors when necessary'.<sup>613</sup> Except for smaller companies (defined as those below the FTSE 350), at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.<sup>614</sup> The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.<sup>615</sup> Appointments to the board should be subject to 'a formal, rigorous and transparent procedure'.<sup>616</sup>

As it is their role to challenge the executive directors and to contribute to the strategy of the company, non-executive directors potentially hold an important position for the promotion of CSR. As they are in the boardroom, they can critically engage with the decisions of the executive directors and add CSR considerations into the decision-making process. However, the fact that non-executive directors continue to be the subject of critical reviews<sup>617</sup>, demonstrates that they are obviously not always sufficiently exercising their function to monitor and to challenge the work of the executive directors. The economic and financial crisis has revealed several examples of non-executive directors who have not sufficiently monitored the board.<sup>618</sup> When looking into the failure of Northern Rock, the Treasury Committee criticised the company's non-executive directors for their failure to restrain the CEO.<sup>619</sup> The non-executive directors failed to ensure that the company remained liquid and solvent and to prevent the unacceptable risks the company took.<sup>620</sup> And in his review of corporate governance in UK banks and other financial industry entities, Sir David Walker questioned whether 'the long established conventional wisdom and practice that non-executive directors make an essential contribution to governance continues to be as realistic as previously envisaged'.<sup>621</sup> These examples underline that there are many instances where non-executive directors have not properly discharged their duties to monitor and critically challenge the decision-making

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<sup>613</sup> *ibid*, A.4: Non-executive directors, A.4.1.

<sup>614</sup> *ibid*, B 1: The Composition of the Board, B 1.2.

<sup>615</sup> *ibid*, B 1: The Composition of the Board, B 1.1.

<sup>616</sup> *ibid*, B 2: Appointments to the Board.

<sup>617</sup> Walker, *A review of corporate governance in UK banks and other financial industry entities, Final recommendations* (November 2009) para 2.2. (iv); See for example: D Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (DTI 2003), available at: <http://www.bis.gov.uk/files/file23021.pdf> (last accessed 28/03/2012).

<sup>618</sup> A Arora, 'The corporate governance failings in financial institutions and directors' legal liability' (2011) *Company Lawyer* 3, 5.

<sup>619</sup> House of Commons Treasury Committee, *The run on the rock* (2008), available at: <http://www.parliament.the-stationery-office.com/pa/cm200708/cmselect/cmtreasy/56/56i.pdf> (last accessed 06/01/2012).

<sup>620</sup> *ibid*.

<sup>621</sup> Walker, *A review of corporate governance in UK banks and other financial industry entities, Final recommendations* (November 2009) para 2.2 (iv).

process.<sup>622</sup> This issue is important here as non-executive directors have potential to put CSR on the agenda in the boardroom. However, whether they do this depends on the question of whether they fully engage with the running of the company.

The important function of non-executive directors in the monitoring of the board has been acknowledged in several company law reviews. Prior to the enactment of the Companies Act 2006, the White Paper *Modernising Company Law* already emphasised the central role of non-executive directors in corporate governance in terms of accountability.<sup>623</sup> The 2009 Walker Review of corporate governance in UK banks and other financial industry entities provides several suggestions with regard to the role of non-executive directors which are of interest for corporate governance generally.<sup>624</sup> The final recommendations suggest that non-executive directors ought to be given a sufficient introduction into their role.<sup>625</sup> The report further emphasises that non-executive directors in a major bank would be expected to commit a minimum amount of time in the area of 30 to 36 days which should be clearly indicated in letters of appointment.<sup>626</sup> Although this report is directed at major banks, it does hint at an important issue, namely the time non-executive directors devote to the respective board(s) on which they sit. The recommendations also emphasise the function of non-executive directors to challenge decisions of the board. This aspect of the role of non-executive directors is particularly important for CSR as non-executive directors can contribute a consideration of stakeholder interests to the decision-making process (this point is discussed in the next section 'The composition of the boardroom'). Despite all these discussions, the Walker Review rejects the idea of more statutory regulation of corporate governance. It is argued in the Review that such regulation would increase the risk of litigation and would not have prevented the corporate governance failures in the financial services industry.<sup>627</sup>

Whilst it is beyond the scope of this chapter to fully discuss whether the duties of non-executive directors ought to be included in the Companies Act or remain in the UK Corporate Governance Code, it is submitted here that it needs to be considered that the system based on 'comply or explain' has not prevented the failures of non-executive directors in the run-up to the current economic and financial crisis. It

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<sup>622</sup> B Hannigan, 'Board failures in the financial crisis: tinkering with codes and the need for wider corporate governance reforms: Part 2' (2012) *Company Lawyer* 35, 41.

<sup>623</sup> Company Law Review, *The White Paper: Modernising Company Law* (DTI 2002, Cm 5553-I and Cm 5553-II).

<sup>624</sup> Walker, *A review of corporate governance in UK banks and other financial industry entities: Final recommendations* (November 2009).

<sup>625</sup> *ibid*, Recommendation 1.

<sup>626</sup> *ibid*, Recommendation 3.

<sup>627</sup> *ibid*, paras 1.15 – 1.21.

seems that the recent corporate governance failures, including the lack of sufficient monitoring by non-executive directors, mirror the situation in the early 1990s which occurred prior to the beginning of the whole corporate governance debate in the UK. The several reviews of corporate governance and the creation of codes of conduct since then do not appear to have achieved much in light of the scale of corporate governance failures. It is therefore doubtful if some amendments of the codes, as suggested in the Walker Review, do really suffice to improve the quality of the work of non-executive directors in the UK boardrooms in a sustained manner.

These discussions reveal a rather critical view of the way in which many non-executive directors exercise their function at present. This situation has direct ramifications for the promotion of CSR in the boardroom. If non-executive directors do not devote enough time to their jobs or do not sufficiently challenge business decisions or contribute their positions to debates, then it is unlikely that they will achieve much for the promotion of CSR. The discussions about the role of non-executive directors form the background to the issue of board composition in the next section.

#### **3.4.4.2 The composition of the board**

The composition of the board is closely connected with the question what contribution non-executive directors can make to the promotion of CSR.<sup>628</sup> A more diverse board could potentially lead to a better inclusion of stakeholder interests in the decision-making process. This idea has been taken up at the European Union level. The 2011 Green Paper on the EU Corporate Governance Framework focuses on three key areas which form part of this chapter due to their relevance for the implementation of CSR: The effective functioning of the board, enhancing shareholders' engagement and improving the monitoring and enforcement of the existing national corporate governance codes.<sup>629</sup> These issues have now been taken forward in the European Commission's action plan on company law and

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<sup>628</sup> Within the space of this chapter it is impossible to compare the one-tier board structure of English companies with two-tier systems such as the German corporate governance system (that has a managing board and a supervisory board). The German model generally provides for a stronger representation of employees in the decision-making process. In the German model, employees in German public limited companies (*Aktiengesellschaften*) make up to 50% of the members on the supervisory board. Moreover, employees are involved in the decision-making process of companies through works councils. See for an introduction: F Schwarz, 'The German co-determination system: a model for introducing corporate social responsibility requirements into Australian law? Part 1' 2008, 23 *JIBLR* 125; F Schwarz, 'The German co-determination system: a model for introducing corporate social responsibility requirements into Australian law? Part 2' (2008) 23 *JIBLR* 190.

<sup>629</sup> European Commission, 'The EU corporate governance framework' COM (2011) 164 final.

corporate governance, published in December 2012.<sup>630</sup> In terms of the board composition, the focus of the action plan was on improving transparency on board diversity, a suggestion that has been taken up with the proposed Directive on narrative reporting. The issue of gender balance at board level, most notably whether there should be a binding female quorum is currently debated at EU and member state level.<sup>631</sup>

The Green Paper discusses boardroom diversity, in particular the inclusion of women and non-nationals in terms of their positive impact on the effective functioning of the board. The Commission emphasised that it considered 'group think' to be a realistic danger in the current composition of many boards. This aspect is significant for CSR in light of the finding of the BIS study on the new Companies Act referred to above that most directors continue to make decisions in the same way as they used to do before the enactment of s172 (1) CA although this duty was intended to widen considerations in the boardroom beyond only those of shareholders.<sup>632</sup> Whilst part of the problem with s172 (1) CA for the promotion of CSR is the firm embedding of the duty in the shareholder value doctrine, the other issue is that the directors do not sufficiently make use of their discretion in the decision-making process. Boards of directors that are more diverse could lead to a greater consideration of CSR issues at board level. To that end, a more diverse group of non-executive directors could better contribute the perspective of stakeholders to the decision-making process of the board in order to give full recognition to the list of factors in s172 (1) CA. Non-executive directors from a variety of backgrounds are less likely 'to wear the same lenses'. Patterns of thought are more likely to differ. And in particular non-executive directorships could be given to individuals with a view of promoting CSR goals and bringing stakeholder

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<sup>630</sup> European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies' COM (2012) 740 final, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF> (last accessed: 21/05/2013).

<sup>631</sup> In November 2012 the Commission proposed a Directive setting a 40% objective of female representation at board level in publicly listed companies with the exception of small and medium-sized enterprises. The objective should be met by 2020. The proposed Directive is still subject to discussions, however, and it is yet not clear if it is going to be enacted. The Irish Presidency has scheduled a discussion at the meeting of Employment and Social Affairs ministers (EPSCO Council) on 20 June 2013. The EU Justice Commissioner Viviane Reding argues for the introduction of a binding female quorum. At the same time, the issue of a binding quorum is also debated in EU member states. The German Federal Parliament (Bundestag) voted against a statutory female quorum in April 2013, following a heated debate. See for an overview about the issue: European Commission, 'Women on Boards: Vice-President Viviane Reding and Markus Klimmer, Managing Director at Accenture discuss challenges and opportunities' (MEMO/13/430, 14<sup>th</sup> May 2013), available at: [http://europa.eu/rapid/press-release\\_MEMO-13-430\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-430_en.htm) (last accessed: 21/05/2013).

<sup>632</sup> Department for Business, Innovation and Skills, *Evaluation of the Companies Act 2006, Volume One* (2010) 72.

perspectives into the decision. As long as non-executive directors continue to only commit little time and as long as board members tend to have a similar personal and professional background, discussions about the direction of the company will not arise to the same extent as if these people had a more diverse professional and personal background. This idea is taken up by the Green Paper which warns that a board consisting of executive directors with a similar personal and professional background is less likely to challenge traditional patterns of thought. And, as an example relating to the diversity in the boardroom, research shows that gender balance in UK boardrooms is far from being achieved. The Female FTSE Index Report for 2010 shows that merely 7.8% of FTSE 250 board directors are women.<sup>633</sup> The number was at 7.6% in the previous year.<sup>634</sup>

These deliberations further support the argument made in this chapter that, apart from the question of the underlying corporate doctrine, the key to effectively promote CSR through corporate governance is the boardroom. In light of the flaws of s172 (1) CA, the shortcomings of the reporting duty in s417 CA (albeit the improvements that the proposed Directive on nonfinancial reporting will bring, if it is adopted) and the rare use of the derivative action, the people who make the business decisions appear to be central for the enhancement of greater CSR. The studies referred to above are right with their warning of 'group think', as a more uniform background of the directors is likely to lead to more agreement among them. Considerations of the interests of the various stakeholders and CSR are less likely to occur in such circumstances. Having executive and non-executive directors who come from a more diverse background might widen the discussions in the boardroom to consider a broader range of interests including CSR.<sup>635</sup> It is therefore argued here that the behavioural changes which were intended with s172 (1) CA depend on the people who sit on the board. Or put it another way: The discretion that s172 (1) allows,

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<sup>633</sup> The Female FTSE Index Report for 2010, available at: <http://www.som.cranfield.ac.uk/som/dinamic-content/research/documents/FemaleFTSEReport2010.pdf> (last accessed 04/01/2012).

<sup>634</sup> The Female FTSE Index Report for 2009, available at: <http://www.som.cranfield.ac.uk/som/dinamic-content/research/documents/ft2009.pdf> (last accessed 04/01/2012). In May 2011 the Financial Reporting Council began consulting on possible amendments to the Code that would require companies to publish their policy on boardroom diversity and report against it annually. This follows the recommendations of Lord Davies in his report 'Women on Boards', published in February 2011. In October 2011, the FRC announced that these changes would be implemented in a revised version of the UK Corporate Governance Code which will be issued in 2012 and which will apply to financial years beginning on or after 1 October 2012. See: <http://www.frc.org.uk/corporate/ukcgcode.cfm> (last accessed 28/03/2012). For a discussion of this topic see C Villiers, 'Achieving gender balance in the boardroom: is it time for legislative action in the UK?' (2010) 30 *Legal Studies* 533; K Pieters, 'More efforts needed to improve gender equality in corporate governance in the EU' (2012) 13 *EBOLR* 475.

<sup>635</sup> L E Mitchell, 'The board as a path toward corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 283.



despite its weaknesses, are more likely to be used if there is a broader range of directors at the board.

Although non-executive directors have not yet contributed much to the promotion of CSR, they have potential to do so. The planned reporting duties about gender diversity and the currently debated issue of female representation at board level highlight that there is an increasing realisation that the board is, at least potentially an effective tool of corporate governance to achieve behavioural changes. So, whilst this argument is more about the way forward for corporate governance than about the status quo, it does provide a starting point for a better promotion of CSR through corporate governance. A more diverse board would still only be able to work within the framework of s172 (1) CA and its emphasis on shareholder value, however. Directors are still restricted in their decision-making by the duty to strive to maximise the benefit of the members, i.e. the shareholders. Nevertheless, despite its limitations to enhance CSR, s172 (1) CA at least provides directors with some discretion about how they consider ('having regard to') stakeholder interests. They are allowed to promote CSR as long as they can justify that they considered their decision to ultimately promote the interests of the members as a whole. Whether they do choose to promote CSR within the scope of s172 (1) CA, depends on the directors themselves, which supports the argument made here that the board is the key to effectively promote CSR.

### **3.5 Conclusion**

This chapter has shown that the system of corporate governance within the framework of the enlightened shareholder value doctrine has at least in theory the potential to promote CSR. Corporate governance and CSR overlap in different areas which are addressed here: the duty to promote the success of the company for the benefit of the members as a whole (s172 CA), the reporting duty (s417 CA), the derivative action (s260 CA) and the board. There is a strong correlation between the list of factors in s172 (1) CA and the concept of CSR. Nevertheless, the conclusions drawn from the different aspects of company law and corporate governance analysed in this chapter in terms of promoting CSR are rather disappointing. In particular the duty in s172 (1) CA has so far not achieved much for the promotion of CSR. The present state of English company law contrasts with the announcements of the government about the long-term view that English company law would take, following the enactment of the Companies Act 2006 with the enlightened shareholder value model. In reality, not much has been achieved from a CSR point of view so far.

The various aspects analysed in this chapter all have severe shortcomings in the promotion of the socially responsible conduct of companies. CSR is too much left to the discretion of directors. One can critically ask what the real meaning of enlightened shareholder value is in English law, in light of the results of the legal analysis here. The interests of stakeholders and the concept of CSR continue to be subordinated under the shareholder value prerogative. The ultimate beneficiaries of the company remain the shareholders with only discretionary consideration of other aspects. The analysis of the s172 (1) CA duty, the business review<sup>636</sup> and the derivative action has demonstrated that English company law and corporate governance are still too embedded in the shareholder value model to effectively promote CSR. Moreover, it is doubtful if the recent focus on institutional investors is going to significantly change things for the better. The UK Stewardship Code contains only little recognition of social and environmental matters. And, more generally, it is doubtful whether investors will go beyond scrutinising their investee companies and push for a stronger CSR policy. The conclusion of this chapter therefore is that, despite their overlap with CSR, English company law and corporate governance contribute only little to the promotion of CSR in practice. This situation is unlikely to change without a redirection of the corporate objective in English law to a more pluralistic understanding of the firm.

Nevertheless, the chapter has also shown that English company law could better promote CSR. Leaving aside the fundamental question of the underlying model of the company, it has been shown here that the boardroom could be an effective area for the promotion of CSR. There are two starting points for using the board as a means to better promote CSR. The first one is to improve the way many non-executive directors exercise their function to monitor and to challenge decisions in the boardroom. The second way is to achieve more diversity in the boardroom. It is argued here that the inclusion of CSR in the decision-making process not only depends on the formulation of directors' duties in the Companies Act, but that it also depends on the kind of people who sit on boards. If the directors come from a more diverse background, there are higher chances that traditional patterns of thought are challenged and that moves towards a stronger inclusion of CSR into business decisions are made. Despite its prioritisation of maximising shareholder value, s172 (1) CA at least provides discretion for directors to consider CSR as long as they believe in good faith that their decision ultimately promotes the interest of the members. It is within this narrow framework that company law and corporate

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<sup>636</sup> However, the proposed Directive on nonfinancial reporting, if introduced, would improve the disclosure of CSR matters.

governance can make a contribution to the promotion of CSR, if directors choose to do so.



## Chapter 4: English contract Law and Corporate Social Responsibility

### 4.1 Supply chains and CSR

In the course of globalisation, companies no longer produce their goods completely themselves within the national boundaries of the country where the company's headquarters are, but rather distribute their production to suppliers in different countries around the world through supply chains.<sup>637</sup> Companies in the global North and West have increasingly outsourced parts of their production to suppliers in developing and transitional countries in order to reduce cost.<sup>638</sup> To that end they have developed sophisticated supply chains as a business tool.<sup>639</sup> The supply chain is defined as the series of companies, including suppliers, customers, and logistics providers which work together to deliver a value package of goods and services to the end customer.<sup>640</sup> Global supply chains function across different countries and different cultures.<sup>641</sup> This process of outsourcing to suppliers is particularly prevalent in labour-intensive production industries such as the garment industry and also in the food industry.<sup>642</sup> The buyers in these supply chains are often multinational companies.<sup>643</sup>

However, reports about human rights violations of employees of some suppliers in the developing world, for instance through the use of child labour, unsafe working conditions or excessive working hours, have negatively affected the reputation of some Western companies which trade with these suppliers.<sup>644</sup> Similarly, the pollution

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<sup>637</sup> See M Andersen and T Skjoett-Larsen, 'Corporate Social Responsibility in global supply chains' (2009) 14 *Supply Chain Management: An International Journal* 75, 77.

<sup>638</sup> A Millington, 'Responsibility in the Supply Chain' in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 363.

<sup>639</sup> R Eltantawy, G Fox and L Giunipero, 'Supply management ethical responsibility: reputation and performance impacts' (2009) 14 (2) *Supply Chain Management: An International Journal* 99.

<sup>640</sup> M Maloni and M Brown, 'Corporate Social Responsibility in the Supply Chain: An Application in the Food Industry' (2006) 68 *Journal of Business Ethics*, 35, 36.

<sup>641</sup> C Muller, W Vermeulen and P Glasbergen, 'Pushing or Sharing as Value-driven Strategies for Societal Change in Global Supply Chains: Two Case Studies in the British-South African Fresh Fruit Supply Chain' (2012) 21 *Business Strategy and the Environment* 127, 129.

<sup>642</sup> I Mamie, 'Managing Global Supply Chain: The Sports Footwear, Apparel and Retail Sectors' (2005) 59 *Journal of Business Ethics* 81.

<sup>643</sup> See the introduction into the concept of a 'multinational corporation' in chapter 1. It is important to note that CSR does not only apply to multinational companies.

<sup>644</sup> See *The Guardian*, 'Apple factories accused of exploiting Chinese workers' (30 April 2011), available at: <http://www.guardian.co.uk/technology/2011/apr/30/apple-chinese-factory-workers-sweatshops>; *The Independent*, 'Leading article: The gruesome reality of sweatshops' (1 October 2010), available at: <http://www.independent.co.uk/opinion/leading-articles/leading-article-the-gruesome-reality-of-sweatshops-2094318.html?origin=internalSearch> (last accessed: 24/4/2013); R Locke et al., 'Beyond corporate codes of conduct: Work organization and labour standards at NIKE's suppliers' (2007) 146 (1-2) *International Labour Review* 21.

of the environment through poor production standards at the suppliers' factories<sup>645</sup> has become public causing a negative impact on the reputation of some of the Western companies which use supply chains.<sup>646</sup> The suppliers are often based in developing countries with weak legal standards in terms of human rights and/or a weak system of law enforcement.<sup>647</sup> The supply chain has therefore become increasingly scrutinised by NGOs, trade unions and consumers.<sup>648</sup> The UN Guiding Principles on Business and Human Rights refer to the responsibility of companies to 'seek to prevent or mitigate adverse human rights impacts' linked to their supply chain.<sup>649</sup> At the EU level level, a document on responsible supply chain management was published in 2010, commissioned under the European Union's Programme for Employment and Social Solidarity - PROGRESS (2007-2013).<sup>650</sup> As a consequence of this increasing interest in the supply chain, Western multinational companies, particularly those with well-known brands,<sup>651</sup> have come under increasing public and political pressure to expand their CSR engagement to their supply chain and to show that they are socially responsible in their supply chain.<sup>652</sup> Many multinational companies therefore began to implement CSR policies into their supply chain.<sup>653</sup> To that end companies usually develop their own code of conduct or adopt a code developed by a third party which contains the company's policy on CSR and the principles it expects everyone within the company to uphold.<sup>654</sup> Many

<sup>645</sup> David Barboza, 'Apple Cited as Adding to Pollution in China', *The New York Times* (1 September 2011), available at: [http://www.nytimes.com/2011/09/02/technology/apple-suppliers-causing-environmental-problems-chinese-group-says.html?\\_r=1](http://www.nytimes.com/2011/09/02/technology/apple-suppliers-causing-environmental-problems-chinese-group-says.html?_r=1) (last accessed 24/6/2012).

<sup>646</sup> C Soosay, A Fearne and B Dent, 'Sustainable value chain analysis – a case study of Oxford Landing from "vine to dine"' (2012) 17 *Supply Chain Management: An International Journal* 68.

<sup>647</sup> A Millington, 'Responsibility in the Supply Chain' in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 364.

<sup>648</sup> P Robinson, 'Do Voluntary Labour Initiatives Make a Difference for the Conditions of Workers in Global Supply Chains?' (2010) 52 *Journal of Industrial Relations* 561, 564; D Hoang and B Jones, 'Why do corporate codes of conduct fail? Women workers and clothing supply chains in Vietnam' (2012) 12 *Global Social Policy* 67, 68.

<sup>649</sup> Principle 13, UN Guiding Principles on Business and Human Rights, see: 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework', available at: <http://www.business-humanrights.org/SpecialRepPortal/Home/Protect-Respect-Remedy-Framework/GuidingPrinciples> (last accessed: 27/04/2013).

<sup>650</sup> M van Opijnen and Joris Oldenzien, *Responsible Supply Chain Management, Potential success factors and challenges for addressing prevailing human rights and other CSR issues in supply chains of EU-based companies* (2010), available at: [http://ec.europa.eu/enterprise/policies/sustainable-business/files/business-human-rights/final\\_rscm\\_report-11-04-12\\_en.pdf](http://ec.europa.eu/enterprise/policies/sustainable-business/files/business-human-rights/final_rscm_report-11-04-12_en.pdf) (last accessed: 07/06/2013).

<sup>651</sup> D Hoang and B Jones, 'Why do corporate codes of conduct fail? Women workers and clothing supply chains in Vietnam' (2012) 12 *Global Social Policy* 67, 67.

<sup>652</sup> See L. Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 471; M Thomas, 'Global Industrial Relations? Framework Agreements and the Regulation of International Labour Standards?' (2011) 36 *Labour Studies Journal* 269, 272; J Leigh and S Waddock, 'The Emergence of Total Responsibility Management Systems: J.Sainsbury's (plc) Voluntary Responsibility Management Systems for Global Food Retail Supply Chains' (2006) 111 (4) *Business and Society Review* 409, 410.

<sup>653</sup> M Andersen and T Skjoett-Larsen, 'Corporate Social Responsibility in global supply chains' (2009) 14 *Supply Chain Management: An International Journal* 75, 77.

<sup>654</sup> D Wells, 'Too Weak for the Job: Corporate Codes of Conduct, Non-Governmental Organisations and the Regulation of International Labour Standards' (2007) 7 *Global Social Policy* 51, 52; R Locke, F Qin and A Brause, 'Does Monitoring Improve Labor Standards? Lessons From NIKE' (2007-2008) 61

companies incorporate a CSR code of conduct into their supply chain contracts with their suppliers, although they do so differently and with different contractual effect.<sup>655</sup> The corporate codes of conduct are defined as documents which state a number of social and environmental standards and principles that a firm's suppliers are expected to fulfil.<sup>656</sup> This incorporation of the buyer's CSR policies into the supply contract is an interesting development, given that the codes of conduct of companies are often criticised for being non-binding.<sup>657</sup> Studies have analysed the proliferation of such CSR codes of conduct amongst the FTSE 100 companies.<sup>658</sup> A study published in 2010 shows that 77 out of the 100 constituent FTSE 100 firms had adopted such codes and many companies have policies about ethical sourcing which they integrate into the supply chain relations with their suppliers.<sup>659</sup> In terms of content, most of these ethical sourcing policies stipulate requirements to uphold employee working conditions and health and safety at work, freedom of association, decent remuneration for employees, respect for human rights and a commitment to environmental policies.<sup>660</sup> The principles are often based on well-known CSR standards such as the UN Global Compact, the ETI Base Code, the ILO Declaration

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*Industrial and Labor Relations Review* 3, 4. Pearson and Seyfang define these codes of conduct in the following way: '...codes of conduct are voluntary self-regulatory tools that are applicable to specific firms, or groups of firms, and thus to certain groups of workers at certain times, rather than applying to all citizens or workers in particular states', see R Pearson and G Seyfang, 'New Hope or False Dawn?: Voluntary Codes of Conduct, Labour Regulation and Social Policy in a Globalising World' (2001) 1 *Global Social Policy* 48, 52

<sup>655</sup> A Tencati, A Russo and V Quaglia, 'Unintended consequences of CSR: protectionism and collateral damage in global supply chains: the case of Vietnam' (2008) 8 (4) *Corporate Governance* 518, 520; E Pedersen and M Andersen, 'Safeguarding corporate social responsibility (CSR) in global supply chains: how codes of conduct are managed in buyer-supplier relationships' (2006) 6 *Journal of Public Affairs* 228, 237; B Jiang, 'Implementing Supplier Codes of Conduct in Global Supply Chains: Process Explanations from Theoretic and Empirical Perspectives' (2009) 85 *Journal of Business Ethics* 77, 77-78.

<sup>656</sup> I Mamic, 'Managing global supply chains: the sports footwear, apparel and retail sectors' (2005) 59 *Journal of Business Ethics*, 81. These codes are established by individual companies, by industry associations, at national level (e.g. the Ethical Trading Initiative in the UK; the Department for International Development was involved into the development of this code), at regional level (e.g. Code of Business Conduct by the Asia-Pacific Economic Co-operation) or by international organisations. See for further information: L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 472-473.

<sup>657</sup> See C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) *Company Lawyer* 172, 177

<sup>658</sup> [http://www.ftse.com/Indices/UK\\_Indices/Downloads/FTSE\\_100\\_Index\\_Factsheet.pdf](http://www.ftse.com/Indices/UK_Indices/Downloads/FTSE_100_Index_Factsheet.pdf) (last accessed 12/06/2012).

<sup>659</sup> L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 475: Preuss analysed the range of codes that constituent firms of the FTSE100 index use. His findings show that 77 companies used a general company-wide code of conduct which often also include stipulations for suppliers, 43 companies had adopted ethical sourcing policies which specifically contain what companies expect from their suppliers in terms of CSR standards. Sixteen of the FTSE100 companies were found to have specific codes which regulate the supply chain.

<sup>660</sup> *ibid*, 483.

on Fundamental Principles and Rights at Work or the UN Declaration of Human Rights.<sup>661</sup>

The incorporation of CSR into supply chain contracts has been extensively analysed in the management literature.<sup>662</sup> This literature looks, inter alia, at the motives for including CSR policies into the supply chain such as brand reputation, the content of the codes<sup>663</sup>, the specifics of different industries such as the food industry<sup>664</sup>, the monitoring process<sup>665</sup> and the effects of the codes of conduct<sup>666</sup>. In contrast, there has only been little writing from a legal perspective so far.<sup>667</sup> In fact, there has so far only been a general overview about the use of supply chain contracts to promote CSR through English contract law.<sup>668</sup>

This chapter seeks to contribute to this legal literature by providing a detailed contract law analysis of the incorporation of CSR policies into supply chains.<sup>669</sup> The purpose of this chapter is to answer the question to what extent English contract law promotes socially responsible behaviour in corporations. On the basis of this legal analysis, which determines the circumstances in which contract law is more likely and less likely to have this capacity, the chapter also seeks to make forward-looking

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<sup>661</sup> See M Andersen and T Skjoett-Larsen, 'Corporate Social Responsibility in global supply chains' (2009) 14 *Supply Chain Management: An International Journal* 75, 78.

<sup>662</sup> See for example: J Leigh and S Waddock, 'The Emergence of Total Responsibility Management Systems: J. Sainsbury's (plc) Voluntary Responsibility Management Systems for Global Food Retail Supply Chains (2006) 111 (4) *Business and Society Review* 409 – 426; B Jiang, 'Implementing Supplier Codes of Conduct in Global Supply Chains: Process Explanations from Theoretic and Empirical Perspectives' (2009) 85 *Journal of Business Ethics* 77 – 92.

<sup>663</sup> A Rasche and D Gilbert, 'Institutionalizing global governance: the role of the United Nation's Global Compact' (2012) 21 (1) *Business Ethics: A European Review* 100.

<sup>664</sup> See M Maloni and M Brown, 'Corporate Social Responsibility in the Supply Chain: An Application in the Food Industry' (2006) 68 *Journal of Business Ethics*, 35.

<sup>665</sup> R Locke, F Qin and A Brause, 'Does Monitoring Improve Labor Standards? Lessons From NIKE' (2007-2008) 61 *Industrial and Labor Relations Review* 3.

<sup>666</sup> See D Wells, 'Too weak for the Job: Corporate Codes of Conduct, Non-Governmental Organisations and the Regulation of International Labour Standards' (2007) 7 *Global Social Policy* 51; A Kolk and R van Tulder, 'The Effectiveness of Self-regulation: Corporate Codes of Conduct and Child Labour' (2002) 20 *European Management Journal* 260.

<sup>667</sup> The two pieces available so far are: D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and "other-regulation"' in D McBarnet, A Voiculescu and T Campbell, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 59 – 92; R Mares, 'The Limits of Supply Chain Responsibility: A Critical Analysis of Corporate Social Responsibility Instruments' (2010) 79 *Nordic Journal of International Law* 193 – 214. The article from Mares primarily reviews how international law instruments address the responsibility of the buyer for the conduct of suppliers and sub-suppliers.

<sup>668</sup> D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and "other-regulation"' in D McBarnet, A Voiculescu and T Campbell, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 59 – 92. This chapter is an introductory piece about the topic. It gives an overview about some of the issues such as monitoring and enforcement.

<sup>669</sup> The chapter also contributes to the literature by analysing the CSR supply chain policies of fifteen FTSE 100 companies. Some of these companies have provided their contractual documents such as standard terms and conditions which they use for purchase orders online. These documents enabled me to analyse the promotion of CSR through supply chain contracts in more detail.



suggestions about what English law could do to encourage greater corporate social responsibility through contract law.

CSR policies can only be enforced in contract law if the following is the case: First, CSR policies must become 'part' of the supply contracts and hence become enforceable (either by the Western company at the head of the supply chain or, for example, by an employee of the supplier, although the privity of contract doctrine makes the enforcement in supply chain contracts a complex issue). Secondly, the Western companies must be able to procure an appropriate remedy in contract law for these breaches. Thirdly, the Western companies (the buyers) must be sufficiently aware of breaches of these contractual terms pertaining to the CSR policies in order to at least consider using contract law to promote socially responsible behaviour among those companies in transitional economies where concerns about violation of CSR issues such as human rights are focused. The subsequent analysis will be structured in the order of these three preconditions.

#### **4.2 Jurisdictional scope of the chapter**

Due to the international nature of the supply contracts analysed in this chapter, it is necessary to establish if English courts have jurisdiction and if English law is applicable.<sup>670</sup> The question of whether English contract law is applicable is particularly important here as the thesis focuses on English private law in terms of its jurisdictional scope.<sup>671</sup>

The first issue is whether English courts have jurisdiction to hear a dispute. It is likely that English companies (the buyers) will bring an action for breach of contract at English courts. English courts must apply the Brussels I Regulation in order to determine whether they can assume jurisdiction.<sup>672</sup> Pursuant to Article 4 (1) of the Regulation, if the defendant is not domiciled in an EU member state, the general rule is that the court may apply its traditional rules of jurisdiction subject to Articles 22 and 23.<sup>673</sup> In most cases the defendant will be a supplier from a developing country and he will therefore not be domiciled in an EU member state. The parties

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<sup>670</sup> These are separate issues, as it might be that English courts have jurisdiction, but that they have to decide a dispute on the basis of foreign law or vice versa foreign courts might have jurisdiction, but must decide a case according to English law.

<sup>671</sup> The chapter therefore gains relevance for the thesis overall if the majority of the supply contracts between the UK-based multinational company and the foreign suppliers are indeed governed by English law.

<sup>672</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters" (or Council Regulation (EC) 44/2001).

<sup>673</sup> Article 4 (1): 'If the defendant is not domiciled in a Member State, the jurisdiction of the courts of each Member State shall, subject to Articles 22 and 23, be determined by the law of that Member State.'

can, pursuant to Article 23 (1) of the Regulation, decide that the courts of a member state have exclusive jurisdiction as long as one party to the contract is domiciled in a member state.<sup>674</sup> This is indeed the case in the terms and conditions reviewed for this chapter. They all contain a clause which stipulates that English courts have exclusive jurisdiction.<sup>675</sup> This prorogation of justice must satisfy formal requirements which is, for instance, the case if the agreement is 'in writing', Art 23 (1) (a). If the clause conferring jurisdiction is included in general conditions then the requirement 'in writing' is met if the contract signed by both parties contains an express reference to the general condition.<sup>676</sup> The companies reviewed for this chapter commonly use terms and conditions which contain such a prorogation of justice for English courts. For it to be effective, the contract must be signed by both parties and contain an express reference to the general conditions of the buyer.<sup>677</sup> In these situations English courts would have jurisdiction over claims based on the supply contract with a supplier from a non-EU country.

When English courts are asked to hear an international contractual dispute, they have to apply the Rome I Regulation to determine the law governing the contract.<sup>678</sup> This Regulation governs choice of law in the European Union and is hence applicable to English courts in their decision which law governs a contract. For the Regulation to be applicable it is not necessary that the parties have a connection to the EU. What is required is that an action is brought at a court of an EU member state and that the case raises the question which law is applicable. The Regulation applies to situations involving a conflict of laws situation in contractual obligations in

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<sup>674</sup> Section 7, Prorogation of jurisdiction, Article 23 (1): 'If the parties, one or more of whom is domiciled in a Member State, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction.'

<sup>675</sup> For example, Rio Tinto's terms and conditions for purchase orders contain the following clause in its section 23 (a) Law: '...and the Supplier irrevocably and unconditionally submits to the exclusive jurisdiction of the English courts for all purposes in connection herewith.'

<sup>676</sup> Case 24/76 *Estasis Salotti di Colzani Aimò e Gianmario Colzani v RÜWA Polstereimaschinen GmbH* [1976] ECR 1831.

<sup>677</sup> In case of a defendant domiciled outside the EU where no such prorogation of jurisdiction has been agreed the position in English common law is that English courts have jurisdiction if the defendant is amenable to the court's jurisdiction. If the defendant is not present in England (as will be the case in the situation underlying this chapter), the English courts have jurisdiction if he has submitted to their jurisdiction. In cases where the defendant is not present in England or Wales and has not submitted to the jurisdiction (likely to happen in the buyer-supplier scenario here) then the court may have the power under CPR rules 6.36 and 6.37 and its Practice Direction to assume jurisdiction by giving permission for process to be served on the defendant out of the jurisdiction. The power to give permission arises when the events or the subject-matter of the dispute are connected with England (see the Practice Directive for the list of special connecting factors). In the case of the supplier producing goods in a developing country for a buyer in the England or Wales it is highly unlikely that either the events or the subject-matter of the dispute are connected with England other than that the goods are to be delivered to the buyer who is based in England or Wales. See: C Clarkson and J Hill, *The Conflict of Laws* (4<sup>th</sup> edn, OUP 2011) 67.

<sup>678</sup> (Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations). Article 2 of the Regulation provides that the law specified by the Regulation shall be applied whether or not it is the law of a Member State.

civil and commercial matters. 'Contractual obligations' are not defined in the Regulation, but a broader approach to this term is suggested.<sup>679</sup> A distinction is made between the situation where parties have chosen a law in their contract and where no governing law was chosen by the parties. Pursuant to Article 3 (1) of the Rome I Regulation the parties have freedom of choice to determine the law applicable to their contract.<sup>680</sup> The supply contracts analysed for this chapter all contained a choice of law clause in the buyer's general terms and conditions which determined English law as the applicable law for the contract.<sup>681</sup> Such a choice of law clause is likely to be included in most supply chain contracts due to the strong bargaining position of the buyer. Article 3 is satisfied where a contract has been concluded by reference to one of the parties' general terms and conditions which include a choice of law clause as long as there is consensus that the contract is concluded on those contractual terms.<sup>682</sup> Insofar the supply chains contracts of the companies reviewed here are governed by English law. It is to be expected that this choice of English law through the buyer's terms and conditions is the norm for other buyers based in the England or Wales, as choosing English law makes the legal situation more predictable for them due to their familiarity with their own legal system.<sup>683</sup> This argument is further supported by the situation that English law is generally the law of choice in international commercial contracts.<sup>684</sup> And one can expect that the larger buyers based in England or Wales will not take the risk of not

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<sup>679</sup> C Clarkson and J Hill, *The Conflict of Laws* (4<sup>th</sup> edn, OUP 2011) 206.

<sup>680</sup> This provision means that parties have autonomy to decide amongst themselves which law should govern them. Article 3 (1), Freedom of choice: 'A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.' It is important to note that this provision requires that the choice of the parties must be 'made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case'.

<sup>681</sup> The effectiveness of the buyer's terms and conditions for the supply contract is a separate legal issue which is addressed below. It is assumed here. In fact, the analysis below will show that in most cases the buyer's terms and conditions are effective. An example of such a choice of law clause in the buyer's standard terms and conditions for supply contracts is Unilever's General Terms & Conditions of Purchase of Goods of Unilever Supply Chain, section 15.9: 'The parties agree that the Contract is an international contract and each party (a) agrees that the Contract (and each part including the Call-Off) and any UPCs and Call-Offs shall be governed by and construed in accordance with English law....'

<sup>682</sup> *Iran Continental Shelf Oil Co v IRI International Corp* [2002] CLC 372. The situation is more difficult where the parties have indirectly identified the applicable law or where an implied choice is made, see for further information: C Clarkson and J Hill, *The Conflict of Laws*, (4<sup>th</sup> ed., OUP 2011) 210 – 217.

<sup>683</sup> The model agreement for the purchase and supply of goods recommends a choice of law clause which determines English law to be the applicable law: Article 21.11, Law and jurisdiction: "The validity, construction and performance of this Agreement shall be governed by English law and shall be subject to the [non-]exclusive jurisdiction of the English courts to which the Parties submit.

<sup>684</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 1.4. The Law Society of England and Wales has even prepared a booklet for foreign businesses emphasizing the benefits of choosing English law for their commercial contracts. English law has therefore become an "export product" in international trade. See: The Law Society of England and Wales, England and Wales: The jurisdiction of choice, available at: [http://www.lawsociety.org.uk/documents/downloads/jurisdiction\\_of\\_choice\\_brochure.pdf](http://www.lawsociety.org.uk/documents/downloads/jurisdiction_of_choice_brochure.pdf) (last accessed 17/06/12).

including a choice of law clause and potentially having their supply contracts governed by the law of the residence of their supplier.<sup>685</sup>

The choice of English law means, for example, that the Sale of Goods Act 1979 applies to international supply contracts.<sup>686</sup> Notably, English law does not draw a formal distinction between domestic and international sales contracts<sup>687</sup> which means that the law which will be analysed in this chapter is domestic English sales contract law despite the international nature of the supply chain contracts.

### **4.3 Under what circumstances can CSR policies become enforceable contractual terms?**

This section asks if and, if so, how the buyer's CSR policies become enforceable contractual terms.

#### **4.3.1 Introduction: Research method**

The information about CSR in supply chain relationships retrieved from academic literature is complemented by small-scale research conducted for the purpose of this chapter. The websites of fifteen FTSE 100 companies<sup>688</sup> (the ten largest FTSE 100

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<sup>685</sup> In fact, if the parties have not agreed on the applicable law in the contract, the Regulation determines in Article 4 (1) (a) that in case of a contract for the sale of goods the contract shall be governed by the law of the country where the seller has his habitual residence. The habitual residence of a party is determined by Article 19 of the Regulation as being the place where a company has his place of general administration. Clarkson and Hill argue that the favouring of the law where the central administration of the seller is based on the convenience of the parties. It is more likely that the seller's performance is more active and that the seller therefore needs to consult lawyers. In case of mass production and sales to different countries this solution of 'habitual residence of the seller' saves the buyer transaction cost and this solution therefore increases the economic efficiency. Not including a choice of law clause into the supply contract would therefore mean that the supply contracts are governed by the law of the country where the supplier has its general administration. In case of a supplier base across different countries this situation would significantly increase their transaction costs.

<sup>686</sup> C Murray, D Holloway and D Timson-Hunt, *Schmitthoff's Export Trade: The Law and Practice of International Trade* (11<sup>th</sup> edn, Sweet & Maxwell 2007) para 21-001. The legal regime pertaining to the contracts governed by English law could be modified if the Uniform Laws on International Sales Act 1967 and the 1980 Vienna Convention on the International Sale of Goods were applicable. The Uniform Laws on International Sales Act 1967 only applies if it has been chosen by the parties to the contract, s1 (3). This rule means that in English law, the Uniform Laws only apply if the parties opt into them. Still, the terms and conditions of Rio Tinto, for example, expressly exclude the applicability of the Uniform Laws. Contrarily, the general terms and conditions of Unilever are silent on this point which reflects the legal situation. The 1980 Vienna Convention on the International Sale of Goods is only not applicable if the parties to the contract exclude its applicability. This situation is important as the Convention differs from English law in some respects, e.g. the availability of specific performance. However, the general terms and conditions reviewed for this chapter all exclude the applicability of the Vienna Convention.

<sup>687</sup> R Bradgate, *Commercial Law* (3rd edn, OUP 2005) para 7.4. There are only few distinctions between domestic sales and international sales, for instance, s26 of the Unfair Contract Terms Act 1977 excludes 'international supply contracts' from the Act.

<sup>688</sup> The fifteen companies researched are: BHP Billiton, Royal Dutch Shell, HSBC, Vodafone Group, BP, Rio Tinto Group, GlaxoSmithKline, Unilever, British American Tobacco, BG Group, Marks & Spencer, BT Group, Burberry Group, Diageo and Tesco.

companies measured by market capitalisation<sup>689</sup> plus five further companies from industries across the board which are known to have a supplier-base in developing countries<sup>690</sup>) were researched by this author in order to find out what CSR requirements they stipulate for their suppliers. This research had two aims: The first aim was to find out if and, if so, how CSR issues are incorporated into supply chain contracts between the UK-based multinational companies (the buyers) and their suppliers, for instance through inclusion into the buyer's terms and conditions. The second purpose was to obtain contractual clauses which refer to CSR and which are used in the buyer-supplier contractual relations. This small-scale research of the way in which fifteen FTSE100 companies incorporate CSR into their supply chain was necessary as the management literature seems to view the incorporation of CSR into supply chain contracts as given without describing the actual detail of how this is effected. The existing literature rather analyses the content of the CSR policies imposed on suppliers<sup>691</sup>, without examining if these duties have any effect in contract law.

The documents were retrieved from the companies' websites which were searched for information about the companies' CSR policies in general and the incorporation of these into the supply chain relations in particular. Previous studies of CSR among companies which were more comprehensive than the research conducted for this chapter also only used the material available online.<sup>692</sup> The analysis of information available on corporate websites is perceived as being a reliable research method to obtain CSR documents.<sup>693</sup> The reason for this view is that previous research has discovered that the vast majority of corporate CSR documents are on the companies' websites.<sup>694</sup> Notably, in one study where CSR managers were

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<sup>689</sup> As of 9 March 2011 these ten companies are: BHP Billiton, Royal Dutch Shell, HSBC, Vodafone Group, BP, Rio Tinto Group, GlaxoSmithKline, Unilever, British American Tobacco, BG Group; see: <http://www.telegraph.co.uk/finance/markets/8371481/Top-ten-most-valuable-companies-in-the-FTSE-100-in-pictures.html> (last accessed 12/06/2012).

<sup>690</sup> These five companies are: Marks & Spencer, BT Group, Burberry Group, Diageo and Tesco.

<sup>691</sup> See L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471; A Tencati, A Russo and V Quaglia, 'Unintended consequences of CSR: protectionism and collateral damage in global supply chains: the case of Vietnam' (2008) 8 (4) *Corporate Governance* 518; K Amaeshi, O Osuji and P Nnodim, 'Corporate Social Responsibility in Supply Chains of Global Brands: A Boundaryless Responsibility? Clarifications, Exceptions and Implications' (2008) 81 *Journal of Business Ethics* 223; P Robinson, 'Do Voluntary Labour Initiatives Make a Difference for the Conditions of Workers in Global Supply Chains?' (2010) 52 *Journal of Industrial Relations* 561.

<sup>692</sup> L Preuss and B Brown, 'Business Policies on Human Rights: An Analysis of Their Content and Prevalence Among FTSE 100 Firms', accepted for publication in *Journal of Business Ethics*, so far the piece is only published online by the journal as 'OnlineFirst', 4.

<sup>693</sup> K Bondy, D Matten and J Moon, 'The adoption of voluntary codes of conduct in MNCs: A three-country comparative study' (2004) 109 (4) *Business and Society Review* 449.

<sup>694</sup> L Preuss and B Brown, 'Business Policies on Human Rights: An Analysis of Their Content and Prevalence Among FTSE 100 Firms', accepted for publication in *Journal of Business Ethics*, so far only published online by the journal as "OnlineFirst" 4.

approached to provide further documents about their CSR policies than just the material which was available on the companies' websites, the additional information received following this request was a mere 3% of the total sample.<sup>695</sup> All fifteen companies selected for the research here have made information available on their website pertaining to their CSR policies. Most of the companies also explain the way they include CSR into their supply chain relationships with their suppliers, e.g. through a reference to the buyer's CSR code of conduct in the standard purchase order forms. Several firms also provide their general terms and conditions which contain the CSR clauses and which they incorporate into their contracts with their suppliers. Finally, the research was further complemented by using model supply contract forms available on the encyclopaedia of forms and precedents on LexisNexis.

With the practical insights it offers into the practice of supply chain contracts, this material informs the legal analysis that follows.

#### **4.3.2 Contractual terms or mere expressions of expectation between the buyer and supplier**

The question is if and, if so, how the corporate codes of conduct become part of the contracts (i.e. contractual terms) between the Western buyer and the supplier based in a transitional economy. This section therefore analyses the ways in which buyers incorporate CSR into their supply contracts. As indicated above, the exact mechanisms of this incorporation are so far somewhat overlooked in the literature about CSR and supply chain management.<sup>696</sup>

The difficulty with the information available on the websites is that some companies only mention that they incorporate the CSR code of conduct that they have adopted into their supply chain contracts without going into further detail and without providing any of the purchase documents themselves. An example of this situation is Burberry which declares in its annual corporate responsibility review that 'all Burberry suppliers are governed by its Ethical Trading Policy...'<sup>697</sup> The word 'govern' could be interpreted in a way that the company's CSR policies are contractual terms. This example can be contrasted with BP, which only states that it 'expects' its suppliers to comply with legal requirements and to operate consistently with the

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<sup>695</sup> L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 472-473.

<sup>696</sup> The chapter will also closely analyse the contract law questions which are raised by this inclusion such as the use of standard business terms. A further difference is the exact analysis of the legal effect of the clauses pertaining to CSR which were found in the documents referred to in this chapter.

<sup>697</sup> [http://annualreview2009-10.burberry.com/corp\\_responsibility/index.html](http://annualreview2009-10.burberry.com/corp_responsibility/index.html) (last accessed 18/6/2012).

principles of its code of conduct.<sup>698</sup> However, a mere 'expectation' such as indicated by BP does not constitute a binding legal obligation upon the supplier. Notably, BP declares that 'work is under way to incorporate these [key performance indicators] into contracts' with its suppliers which implies that the code is not yet contractual, at least in the view of BP.

Other companies, on the contrary, provide their contractual documents that contain CSR terms, e.g. terms and conditions incorporated into purchase order forms. Overall the research of the fifteen companies shows four different ways of incorporating the buyer's CSR policies into the supply chain relationship.

The first and most common mechanism of incorporation seems to be through the terms and conditions of the buyer which are incorporated into the buyer's purchase order forms. These terms and conditions either contain a reference to the buyer's code of conduct (e.g. Unilever and Rio Tinto)<sup>699</sup> or an express term which stipulates the buyer's CSR principles (e.g. GlaxoSmithKline)<sup>700</sup>. An example of a reference to the buyer's code of conduct is the following term in Unilever's terms and conditions:

each supplier...acknowledges that it has reviewed Unilever's Business Partner Code (the "Code") and agrees that all of their activities shall be conducted in accordance with the Code...The Code can be accessed at the internet address...".<sup>701</sup>

The clause in Unilever's terms and conditions that refers to the company's CSR code of conduct is the contractual clause. The code of conduct is not a term of the contract, it is a reference document. It will help determining if the contractual term which refers to it is a condition, warranty or an innominate term (which is discussed later on and is important for the remedy the buyer can procure in case of a breach of the term) and whether or not the supplier is in breach of the term.

The alternative mechanism for incorporating CSR into the buyer's terms and conditions is through an express stipulation in the terms exemplified by GlaxoSmithKline:

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<sup>698</sup> <http://www.bp.com/sectiongenericarticle800.do?categoryId=9048984&contentId=7082805> (last accessed: 03/05/2013).

<sup>699</sup> Rio Tinto London Limited, Purchase Order for the Supply of Goods, Terms and Conditions, section 10 Compliance with law and policies: "In supplying the Goods and associated services (if any), the Supplier will: (a) ...; (b) comply with Rio Tinto's policy titled 'The Way We Work' that can be found at <http://...>"

<sup>700</sup> GlaxoSmithKline, *Terms and Conditions of Purchase (Goods & Services)*, section 21: "Ethical Standards and Human Rights: 21.1. Unless otherwise required or prohibited by law, Supplier warrants to the best of its knowledge, that in relation to the supply of Goods or Services under the terms of the Agreement: 21.1.1. it does not employ engage or otherwise use any form of child labour..."

<sup>701</sup> Unilever, *General Terms and Conditions of Purchase of Goods of Unilever Supply Chain Company AG ("Conditions")* section 13.

21. Unless otherwise required or prohibited by law, Supplier warrants, to the best of its knowledge, that in relation to the supply of Goods or Services under the terms of the Agreement:

21.1.1. it does not employ, engage or otherwise use any child labour in circumstances such that the tasks performed by any such child labour could reasonably be foreseen to cause either physical or emotional impairment to the development of such child...<sup>702</sup>

The difference to the previous example is that the CSR policy is in the contractual term without a reference to a further document. In both these cases the CSR policy of the buyer is contained in the buyer's terms and conditions. The reason for the use of general terms and conditions in purchase orders is that this incorporation saves the buyer a significant amount of time as he does not have to negotiate these contractual terms each time he orders goods.<sup>703</sup> Moreover, by using his terms and conditions, the buyer can include terms which are favourable for him.<sup>704</sup> In this situation, the buyer's CSR policies only become 'part' of the contract if his terms and conditions form part of the contract between the buyer and supplier. This issue will be addressed below.

Secondly, the CSR code of conduct can be incorporated into a contract which is not based on standard terms and conditions, but whose terms were expressly negotiated.<sup>705</sup> In this situation there are two ways of incorporating the buyer's CSR policies which are similar to the previous scenario: Either through reference to the buyer's code of conduct or through express stipulations in the contract. In this situation, the buyer's CSR policy becomes 'part' of the contract when the contract between the two parties is formed (see below).

Thirdly, some companies declare that they incorporate their CSR policies into their invitations to tender.<sup>706</sup> For the CSR policies to have contractual effects in this situation it is necessary that they are incorporated into the subsequent contract between buyer and supplier, either through the first or the second mechanism described above.

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<sup>702</sup> GlaxoSmithKline Terms and Conditions of Purchase (Goods & Services), section 21.

<sup>703</sup> R Bradgate, *Commercial Law* (3rd edn, OUP 2005) para 2.5.3.

<sup>704</sup> *ibid.*

<sup>705</sup> One company – BT – stated that it would not use the terms and conditions for non-UK suppliers. Others said that they reserve the right, when appropriate, not to use the terms and conditions. It is still to be expected that these companies will include CSR as they do in their terms and conditions, as their own reports about their supply chain management indicate this.

<sup>706</sup> BT states that this is one of its ways of how it incorporates its CSR policy into its supply chain: 'Working with BT Generic Standards', 1. Introduction: Generic Standards will form part of the tenderer selection process and will be included in Invitations to Tender and form part of any subsequent contract. The inclusion of Generic Standards into Invitation to Tenders or contracts will be either through the Quality of Suppliers and Generic Standards clause, specifically drafted contract clauses or via inclusion in tender documents by buyers."



Finally, some companies state that they ask their suppliers to sign up to their code of conduct.<sup>707</sup> This mechanism creates contractual effects only if this signing of the code of conduct makes it a term of the contract. However, the privity of contract rule means that it is generally the parties to that contract who can enforce that contractual effect.

The following section analyses if and, if so, how the buyer's CSR policies become 'part' of the contract through these four mechanisms. It will follow the order used in this section with the incorporation of CSR through the buyer's terms and conditions taking priority due to their frequency.

#### **4.3.2.1 Incorporation through the buyer's terms and conditions**

The buyer's terms and conditions, which are usually referred to on the buyer's purchase order form, must form part of the contract, i.e. they must be properly incorporated into the contract. To do this, the buyer and supplier must first of all enter into a contract which presupposes that they reach an agreement, i.e. offer and acceptance.<sup>708</sup> The basic rules as to the formation of contract are the same, irrespective of the type of commercial supply contract.<sup>709</sup> There are different kinds of commercial supply contracts such as the contract for the sale of goods, governed by the Sale of Goods Act 1979, or the contract for the supply of services, governed by the Supply of Goods and Services Act 1982.<sup>710</sup> However, neither of these statutes

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<sup>707</sup> Vodafone, "Checking Compliance:...We ask our preferred and strategic suppliers to sign up to our Code of Ethical Purchasing and to...", see: Vodafone, *Corporate Responsibility – Vodafone UK 2010/11*, available at: [http://www.vodafone.co.uk/cs/groups/configfiles/documents/contentdocuments/cr\\_report\\_2010\\_11.pdf](http://www.vodafone.co.uk/cs/groups/configfiles/documents/contentdocuments/cr_report_2010_11.pdf) (last accessed: 10/12/2012).

<sup>708</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.3. The further requirements for the formation of contract, consideration and intention to create legal relations, are unproblematic in these supply chain contracts and will not be discussed in further detail here. There are no formal requirements for the contract. Consideration is rarely a problem in commercial contracts for the supply of goods or services as businesses do not tend to promise something for nothing, see R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.2.1.

<sup>709</sup> In many cases the classification of the contract will not affect the obligations of the parties as the Sale of Goods Act 1979 and the legislation governing other supply arrangements are similar on certain points, such as implied terms as to quality, see R Bradgate and F White, *Commercial Law – Legal Practice Course Guides* (OUP 2009) para 9.4. The House of Lords has stated that it is undesirable to have unnecessary distinctions between different types of contract, see *Young & Marten Ltd v McManus Childs Ltd* [1969] AC 454.

<sup>710</sup> Further types of supply contracts which transfer ownership and possession of goods are gift, bailment, hire or barter. It usually makes no difference to the rights of the parties if the contract is one of sale or for work and materials. For further information see R Bradgate and F White, *Commercial Law – Legal Practice Course Guides* (OUP 2009) paras 9.4.6., 17.

contains all the rules applicable to these types of contracts, as many rules governing these contracts can be found in the common law or in other statutes.<sup>711</sup>

Offers must contain all integral parts of the contract so that the offeree can just say 'yes'. For example, for contracts of sale of goods the following elements were held to be 'essential elements' of the contract although some terms can be implied into contracts, e.g. default provisions under the Sale of Goods Act 1979: a) the goods ordered should be described without ambiguity, b) the purchase price and the terms of payment should be stated and c) the terms of delivery should be set out, including instructions for packing and invoicing, transportation and insurance.<sup>712</sup> The purchase order form is a commercial document issued by a buyer to a seller which indicates types, quantities, and agreed prices for products or services the seller will provide to the buyer.<sup>713</sup> The sending of a purchase order to a supplier is therefore considered to constitute a legal offer to buy products or services as the buyer makes an order.<sup>714</sup> The purchase order forms used by the buyers (the companies based in the UK) must contain all these essential elements of the contract in order to constitute a binding offer. The incorporation of the buyer's terms and conditions which contain the CSR obligations into the offer will be discussed below.<sup>715</sup>

This offer must be accepted by the supplier (the seller). An acceptance is defined as any statement, by words or conduct, which clearly and unequivocally indicates that the person making it agrees to be bound by the terms of the offer.<sup>716</sup> When accepting, the offeree must not vary or add to the terms of the offer as this would constitute a counter-offer which rejects and terminates the original offer. It is not likely to happen in the supply situation here that the supplier would take the risk of changing the terms. The acceptance must usually be communicated to the offeror. Silence is generally held not to be able to amount to an acceptance although there are some exceptions to this rule.<sup>717</sup> However, the offeror can waive this requirement

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<sup>711</sup> See for further information: R Bradgate and F White, *Commercial Law – Legal Practice Course Guides* (OUP 2009) para 9.1.1.

<sup>712</sup> C Murray, D Holloway and D Timson-Hunt, *Schmitthoff's Export Trade – The Law and Practice of International Trade* (11<sup>th</sup> edn, Sweet & Maxwell 2007) para 3-005.

<sup>713</sup> D Dobler and D Burt, *Purchasing and Supply Management, Text and Cases* (6<sup>th</sup> edn, McGraw-Hill 1996) 70.

<sup>714</sup> *ibid.* The classification of the purchase order as an 'offer' is also suggested by the terms of the terms and conditions of the buyers which are to be incorporated into the supply contract. For instance, GlaxoSmithKline's Terms and Conditions of Purchase (Goods & Services), section 2.2. state: "2. Status of these terms and conditions,...2.2. The Purchase Order constitutes an offer by GSK to purchase Goods or Services specified therein in accordance with these Terms and Conditions...".

<sup>715</sup> The incorporation of the terms and conditions can occur in different ways, for example, by reference to the terms and conditions overleaf or the reference to a website.

<sup>716</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.3.2.

<sup>717</sup> C Murray, D Holloway and D Timson-Hunt, *Schmitthoff's Export Trade: The Law and Practice of International Trade* (11<sup>th</sup> edn, Sweet & Maxwell 2007) para 3-008. *Felthouse v Bindley* (1862) 11 CB NS 869 is often referred to as the authority for this rule. However, there are some exceptions to this

which means that acceptance can be by conduct.<sup>718</sup> In the example of a sale of goods contract, the seller may in this case accept an offer by dispatching the goods that the offeror ordered in the purchase order form. Acceptance of a purchase order by a seller usually forms a one-off contract between the buyer and the seller, so no contract exists until the purchase order is accepted. This system is used to control the purchasing of products and services from external suppliers.<sup>719</sup>

To form part of the supply contract, the general terms and conditions of the buyer must be incorporated into his offer (which is commonly the purchase order).<sup>720</sup> This incorporation can be done by printing the terms and conditions on offers. The text of the offer should at least contain a clear reference to the fact that terms and conditions of purchase are printed on the reverse of the offer or on an attached sheet or on a website.<sup>721</sup> The buyer must obtain the seller's agreement to the terms and conditions. To that end the seller should ideally agree in writing to the offer (countersign), for instance through returning a countersigned acceptance form.<sup>722</sup> Agreement is also possible by conduct, if the other party despatches the goods which happens often in practice. A signed agreement is binding even if the party signing it has not understood or read it.<sup>723</sup> If the parties have not signed an agreement, no terms are incorporated unless the party which wants to incorporate them has drawn the terms to the attention of the party prior to, or at the same time of, the agreement.<sup>724</sup> These rules mean that for the terms and conditions of the buyer to take effect it is important that the offeror (the buyer) clearly refers to them and that the seller (the supplier) agrees to them, ideally by countersignature. Otherwise, the buyer's terms and conditions which contain his CSR policy will not be included into the contract.

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rule, for example: 1.) The offeree's silence can constitute acceptance where there has been a course of dealing whereby the offeree has taken the benefit of services offered, 2.) The offeree's silence will constitute acceptance where it is the offeree who is attempting to hold the offeror to the offeror's stipulation of silence.

See for further information: J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) 57–59.

<sup>718</sup> Bradgate, *Commercial Law* (3rd edn, OUP 2005) para 2.3.2. For instance, GlaxoSmithKline's Terms and Conditions of Purchase (Goods & Services) stipulate the following in section 2.2. "...The Purchase Order and these Terms and Conditions shall be deemed to be accepted by Supplier on the earlier of:

(a) Supplier issuing a written acceptance of the Purchase Order; or (b) Supplier doing any act consistent with fulfilling the Purchase Order, at which point the Agreement shall come into existence."

<sup>719</sup> D Dobler and D Burt, *Purchasing and Supply Management, Text and Cases* (6<sup>th</sup> edn, McGraw-Hill 1996) 70.

<sup>720</sup> C Murray, D Holloway and D Timson-Hunt, *Schmitthoff's Export Trade: The Law and Practice of International Trade* (11<sup>th</sup> edn, Sweet & Maxwell 2007) para 3-017.

<sup>721</sup> *ibid*, para 3-017.

<sup>722</sup> *ibid*, paras 3-010, 3-011, 3-017.

<sup>723</sup> *L'Estrange v Graucob Ltd* [1934] 2 KB 394; *Chellaram & Co v China Ocean Shipping Co* [1991] 1 Lloyd's Rep 493.

<sup>724</sup> *Parker v South Eastern Ry* [1877] 2 CPD 416.

It may be, however, that the buyer's terms and conditions do not become part of the contract due to a practice known as 'battle of the forms'.<sup>725</sup> A 'battle of forms' denotes the situation where one party notifies the other that their general terms apply to the contract, but the other party responds by saying that their general terms will apply.<sup>726</sup> Although such a 'battle of forms' usually occurs in relation to conflicting provisions about the retention of title and exclusion clauses, it is to be expected that the same would apply to conflicting CSR policies. It is the buyer who wants to incorporate his company's CSR code of conduct into his supply contracts whereas the seller might either have less burdensome CSR principles or not have a CSR policy in his terms and conditions at all. In the scenario here, a 'battle of forms' occurs when the buyer orders goods on his terms and conditions of purchase whereas the seller acknowledges the order on his own standard terms of sale.<sup>727</sup> The traditional approach of the English courts is that this situation is analysed in terms of offer and counter-offer.<sup>728</sup> That means where the buyer orders goods on a form which incorporate his standard terms and the seller acknowledges the order on a form that incorporate his terms, the response by the seller will be a counter-offer rather than an acceptance.<sup>729</sup> The 'battle of forms' is usually won by the party who sends the last terms and conditions (commonly described as 'firing the last shot').<sup>730</sup> In that case the seller (supplier) would be in a favourable position to make their terms and conditions win the 'battle' by delivering the goods ordered with a delivery note which contains the seller's standard terms which the buyer may be deemed to accept by keeping the goods. This situation means that the seller's terms and conditions would prevail as they are the last general terms to reach the opposite party. It is possible that the counter-offer is accepted by conduct. In a 'battle of

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<sup>725</sup> R Lawson and S Singleton, *Commercial Contracts: A Practical Guide to Standard Terms* (Tottel Publishing 2006) para A1.17.

<sup>726</sup> *ibid.*

<sup>727</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.3.4; J Adams, 'The Battle of Forms' [1983] *JBL* 297.

<sup>728</sup> *Butler Machine Tool Co Ltd v Ex-Cell-O Corpn* [1979] 1 All ER 965. This case concerns a 'battle of forms'. The supplier quoted for the supply of a machine tool to the buyers. On the back of the quotation was the supplier's terms and conditions which included a price variation clause. The buyer's order contained their conflicting terms and conditions which did not include a price variation clause. The buyer's order contained a tear-off confirmation slip which was subject to the buyer's terms. The supplier completed the form and returned it. The court held that the supplier could not rely on its price variation clause. This assessment of the conflicting terms and conditions was based on an application of the 'last shot' approach. Here it was held that the supplier had accepted the buyer's last shot. This was held to be a counteroffer which was expressly accepted by conforming and returning the tear-off confirmation. This approach was followed by the majority of the judges whereas Lord Denning reached the same conclusion on different grounds. He argued that a contract was formed when the parties agreed on the material points and that the issue whose terms and conditions prevail would depend on the relationship between the parties as a whole. The terms and conditions of both parties would need to be construed together. In this case Denning argued that the acknowledgment by the supplier of the buyer's was decisive.

<sup>729</sup> R Bradgate, 'Formation of contracts' in A Grubb, *The Law of Contract* (3<sup>rd</sup> edn, LexisNexis Butterworths 2007) para 2.221.

<sup>730</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.3.4.

forms' the difficulty is to determine which standard terms apply. The buyers will often try to ensure acceptance of their standard terms by obtaining the signature of their suppliers that they consent to their terms.<sup>731</sup>

In this scenario the incorporation of the buyer's CSR policy into the contract depends on whether or not the suppliers use any conflicting terms and conditions. Moreover, the clause commonly found in the buyers' terms and conditions that their terms would override any conflicting sellers' terms does not prevent the supplier's terms from becoming part of the contract, if they are incorporated later on.<sup>732</sup> However, the buyers can stamp any delivery note they receive from the suppliers with the following statement: 'received under our terms and conditions'.<sup>733</sup> This stamp is regarded as a counter-offer in relation to the terms and conditions and has the effect that the terms of the party using that stamp prevail. In fact, in commercial practice many buyers have adopted the practice of stamping delivery notes with the statement 'accepted subject to our terms' in order to avoid the result that the sellers' terms and conditions override theirs.<sup>734</sup> This option at the time of delivery provides a solution for buyers who want to ensure that their terms and conditions including the CSR policy form part of the contract. Yet, if the stamp is made after the offer was accepted, then it is *ex post facto* (i.e. after the contract came into existence) and has therefore no effect. Hence, the 'battle of forms' depends on the question when the contract came into existence. If a party gets in the 'last shot' after the contract was formed, then it does not make a difference. The crucial question is therefore which

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<sup>731</sup> *Butler Machine Tool Co Ltd v Ex-Cell-O Corpn* [1979] 1 All ER 965.

<sup>732</sup> *ibid.* The sellers offered to supply goods subject to their terms and conditions. The buyers placed an order of the goods on a form which contained a tear-off slip stating that the sellers accepted the order "on the terms and conditions stated therein". This slip had to be signed and returned by the sellers. The sellers signed the slip and returned it with a letter which stated that they were 'entering the order' in accordance with the offer. It was held in this case that the buyer's terms and conditions prevailed since the letter from the sellers did not repeat the sellers' terms and conditions. The sellers therefore did not 'fire the last shot'. This firing was rather done by the buyer who asked the sellers to sign the return slip. The clause in the seller's terms and conditions that these terms would prevail over any others was held to be overridden by the subsequent terms and conditions of the buyer.

An example of such a clause is: RioTinto, *Purchase Order for the Supply of Goods, Terms and Conditions*, sec 1 (d): "Acceptance of the Purchase Order is strictly limited to these Conditions (including attachments to the Purchase Order) and these Conditions shall override and take the place of any other terms or conditions in any document or other communication used by the Supplier in concluding the contract with the Buyer and/or performing under the Purchase Order..., including, without limitation, the Supplier's standard printed terms and conditions,..." The model purchase agreement form (pro-buyer version) stipulates a similar provision: "the seller acknowledges and agrees that the buyer shall not be bound by any of the seller's provisions." See: Encyclopedia of Forms and Precedents, *Commercial Contracts, Forms and Precedents, Agreement for purchase and supply of goods: pro-buyer version*, para 3.1. The important point is that if the terms and conditions are *ex post facto* then they are not effective for that contract.

<sup>733</sup> *BRS v Arthur V Crutchley Ltd* [1968] 1 All ER 811. In this case the claimants delivered a consignment of whisky to the defendants for storage. The defendants received a delivery note from the driver which stated that it would incorporate the claimants' 'conditions of carriage'. The defendants stamped the note with the following statement: 'Received under [our] conditions'. This stamp was considered by the court to amount to a counter-offer which the claimants had accepted by handing over the goods, thus incorporating the defendants' own terms and conditions.

<sup>734</sup> R Bradgate, *Commercial Law* (3<sup>rd</sup> edn, OUP 2005) para 2.3.4.

party got in the 'last shot' (incorporating its terms and conditions) before the contract was formed.

Although in theory, the law on 'battle of forms' appears relevant, it may not be in practice. In commercial practice, due to the strong economic bargaining power of the buyer in international supply contracts, one can expect that buyers can often impose their CSR policies on their suppliers as a prerequisite to trading and that no 'battle of forms' occurs at all. Multinational buyers from Western companies are usually in a position where they can choose between numerous potential suppliers. Their suppliers are therefore unlikely to enter into a 'battle of forms' with their buyers.

Occasionally, it is also possible that the parties start performing (i.e. supplying and paying) before a contract has, in fact, been concluded or that no contract has been concluded at all due to discrepancies in the declarations of the parties.<sup>735</sup> In that case, a court could or could not conclude that a contract came into being and depending on when it came into being a CSR policy may or may not be incorporated.

Finally, the rules on unfair contract terms cannot make invalid the CSR policies which are included in the buyer's terms and conditions. The reason is that the supply chain contracts analysed here consist of a business-to-business situation whereas the unfair contract terms framework, by and large, focusses on business-to-consumer relationships.<sup>736</sup> S3 of the Unfair Contract Terms Act 1977 which

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<sup>735</sup> Where parties commence performance before agreement is reached, it depends on the circumstances if a contract has been concluded in the end and if standard terms are incorporated. See *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504. In this case the court held that the parties had not entered into a contract by being the work that was requested in the letter of intent, as the parties were still negotiating over material contractual terms such as price and delivery dates and it was therefore impossible to say what those terms were. As the parties were ultimately unable to reach final agreement on the price or other essential terms, the contract was eventually not entered into and therefore the work performed in anticipation of it was not referable to any contractual terms as to payment or performance. The defendants were therefore obliged to pay a reasonable sum for the work done pursuant to their request. The standard terms were consequently not binding. But see *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG (UK Production)* [2010] UKSC 14. In that case it was held that the question whether there was a binding contract between parties, and if so upon what terms, required consideration of what was communicated between the parties by words or conduct and whether it led objectively, in accordance with reasonable expectations of honest sensible businessmen, to a conclusion that the parties had intended to create legal relations and had agreed all the terms which they regarded, or the law regarded, as essential for the formation of legally binding relations. Even if certain terms of economic or other significance to the parties had not been finalised, an objective appraisal of their words and conduct could lead to the conclusion that they had not intended agreement of such terms to be a precondition to a concluded and legally binding agreement. Where a draft contract was based on standard terms limiting liability it would be difficult to infer that a party who commenced work before its execution was assuming any liability other than that which the draft contract had envisaged.

<sup>736</sup> The statutory framework consists of the following: The Unfair Contract Terms Act 1977, The Unfair Terms in Consumer Contracts Regulation 1999, The Sale of Goods Act 1979, The Supply of Goods and Services Act 1982 and The Consumer Credit Act 1974. An example of this is The Unfair Contract

applies to both business-to-consumer<sup>737</sup> and business-to-business contracts entered into on standard terms only encompasses the exclusion and restriction of liability or contractual performance.<sup>738</sup> The rules on Unfair Contract Terms would therefore not usually invalidate contractual CSR obligations. In any event, it is important to note that international sales contracts are normally excluded from the scope of the Unfair Contract Terms Act 1977.<sup>739</sup>

#### 4.3.2.2 Incorporation of CSR policy through expressly negotiated contract

In case the buyer does not use terms and conditions, but incorporates his CSR policies into a negotiated contract, it is again necessary that the parties are in agreement, i.e. that there is an offer and an acceptance, as in the previous scenario. In this case the CSR policies of the buyer are only incorporated into the supply contract if the buyer has included this policy into his offer and if the supplier has agreed to it and if the contractual clauses referring to the buyer's CSR policy are then included into the written agreement signed by the parties.

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Terms in Consumer Contracts Regulation 1999 which is applicable only to consumers. A consumer is defined in Art 3 (1) of the Regulation as "any natural person who, in contracts covered by these Regulations, is acting for purposes which are outside his trade, business or profession." This regulation provides that all terms of a contract between a seller or supplier of goods or services and a consumer to the requirement that terms have not been individually negotiated must satisfy the requirement of fairness.

<sup>737</sup> Unfair Contract Terms Act, s12 (1): 'A party to a contract "deals as consumer" in relation to another party if -

(a) he neither makes the contract in the course of a business nor holds himself out as doing so; and (b) the other party does make the contract in the course of a business;...' A partnership or company may not necessarily be making a particular contract in the course of business. In *R. & B. Customs Brokers Co. Ltd v United Dominions Trust Ltd* [1988] 1 WLR 32 the Court of Appeal held that a transaction would be made in the course of a business where it was integral to the nature of the business or, if only incidental to the carrying on of the relevant business, where there was a degree of regularity in entering into such transactions.'

<sup>738</sup> S3: '(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business. (2) As against that party, the other cannot by reference to any contract term - (a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach ; or (b) claim to be entitled - (i) to render a contractual performance substantially different from that which was reasonably expected of him, or (ii) in respect of the whole or any part of his contractual obligation, to render no performance at all, except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.'

<sup>739</sup> Unfair Contract Terms Act 1977, Section 26 excludes international supply contracts. These are defined as (a) being either a contract of sale of goods or being a contract under or in pursuance of which the possession or ownership of goods passes; and (b) it is made by parties whose places of business are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom). Moreover, a contract falls into this category only if either a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from the territory of one State to the territory of another; or b) the acts constituting the offer and acceptance have been done in the territories of different States or c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

#### **4.3.2.3 Incorporation of CSR policy through an invitation to tender**

In the situation in which the buyer incorporates his CSR policy into an invitation to tender, it is again necessary for the CSR policy to be part of the agreement between buyer and supplier. The practice of some companies to issue invitations to submit a tender to supply or buy goods generally constitutes an invitation to treat.<sup>740</sup> Consequently, every person who submits a tender makes an offer and the party which invited tenders (here: the buyer) is in the position to make a choice between the offers.<sup>741</sup> In this case, the incorporation of CSR into the supply contract would depend on the terms of the supplier's offer. If this offer does not contain any CSR clause, then there is no contractual obligation on the supplier to comply with CSR duties. As the supplier makes the offer in this scenario, one would usually expect that the supplier does not include a CSR clause into the offer as it burdens him. However, if the invitee (the buyer) insists on the inclusion of his CSR policy into the subsequent contract by making it a condition of offers, then the CSR policy becomes part of the subsequent contract through the tender process. The potential supplier will then have to include the buyer's CSR policy into the terms of their offer in order to be recognised by the buyer. The declaration from BT that it includes its Generic Standards (which contain the company's CSR policy) into the tenderer selection process and into Invitations to Tender and that these standards form part of any subsequent contract reflects this legal situation. In that situation, the buyer's use of invitations to tender does not preclude the incorporation of the buyer's own CSR policy into the supply contract.

#### **4.3.2.4 Incorporation of CSR policy through signing up to the buyer's code of conduct**

Where the buyer makes his supplier sign up to his CSR code of conduct, the CSR policy can only be enforced in contract law if it is part of the supply contract. The problem with this method of signing up to the code of conduct is that it does not per se incorporate the buyer's code of conduct into the terms of the supply contract. If the seller signs up to the buyer's code of conduct, then the situation is legally comparable to the situation when the buyer himself signs up to codes of conduct. The general view is that codes of conduct are not binding for the companies that

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<sup>740</sup> *Spencer v Harding* [1870] L.R. 5 CP 51. However, the invitee can bind himself to accept the best tender, *Harvela Investment Ltd v Royal Trust of Canada (CI) Ltd* [1986] A.C. 207.

<sup>741</sup> C Murray, D Holloway and D Timson-Hunt, *Schmitthoff's Export Trade: The Law and Practice of International Trade* (11<sup>th</sup> edn, Sweet & Maxwell 2007) para 3-004.



adhere to them.<sup>742</sup> This view means for the supply chain relationship that if the supplier signs up to the buyer's code of conduct this signing up does not create any contractual effects. It is not part of the agreement and hence not part of the contract.

### **4.3.3 The continuing incorporation of the buyer's CSR policy into long-term contractual relationships and informal agreements**

The analysis in the previous section when the buyer's CSR policies become part of the supply contract raises the related question if the buyer's CSR policy remains part of subsequent informal contracts between the parties.

So far, the focus has been on the situation that buyer and supplier enter into a contract for every single order in written form. This situation might be different, however, when the two parties have traded with each other for some time. In commercial practice, contractual relationships between parties are often long-term.<sup>743</sup> Many businesses pursue long-term relationships for the supply of products.<sup>744</sup> Trading partners regularly use informal agreements amongst themselves such as oral agreements or e-mail exchanges.<sup>745</sup> Most commercial contracts tend to be rather informal as they are not clearly defined and are not formally written down.<sup>746</sup> The way contracts are formed also depends on particularities of the respective industries. Industries trading with perishable goods are more likely to use informal agreements. By contrast, industries trading with medical goods tend to employ comprehensively drafted contracts as the production and sale of medical goods is subject to much regulation.<sup>747</sup> It should also be remembered that long-term contracts are commonly considered through the prism of relational contract theory, although that is not necessarily the case.<sup>748</sup> Relational contract theory can apply to both short-term and long-term contract, but in many

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<sup>742</sup> See C Pedamon, 'Corporate social responsibility: a new approach to promoting integrity and responsibility' (2010) *Company Lawyer* 172, 177. However, see the chapter 5 of this thesis which discusses the legal effects of CSR codes of conduct in consumer protection law.

<sup>743</sup> A Millington, 'Responsibility in the Supply Chain' in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 371.

<sup>744</sup> *ibid.*

<sup>745</sup> D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and "other-regulation"' in D McBarnet, A Voiculescu and T Campbell, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 68

<sup>746</sup> T Jenkinson and C Mayer, 'The Assessment: Contracts and Competition' (1996) 12 (4) *Oxford Review of Economic Policy* 3.

<sup>747</sup> D McBarnet and M Kurkchian, 'Corporate social responsibility through contractual control? Global supply chains and "other-regulation"' in D McBarnet, A Voiculescu and T Campbell, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 69.

<sup>748</sup> M Eisenberg, 'Relational Contracts', in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (Oxford 1995). For an introduction into relational contract theory see: D Campbell and P Vincent-Jones (eds), *Contracts and Economic Organisation, Socio-Legal Initiatives* (Aldershot 1996).

different ways.<sup>749</sup> One of the key issues affecting long-term contracts is the need to allow for sufficient flexibility to adjust to changes in the environment.<sup>750</sup> However, these issues are not relevant here, as the important question for this chapter rather is to what extent the long-term nature of many supply chain contracts affects the incorporation of CSR policies. The issue within long-term business partnerships is if the buyer's CSR policy, which was included in the initial supply contracts, either through incorporation of the buyer's terms or conditions or expressly outlined in a closely-defined written contract, continues to be part of subsequent informal contracts such as oral agreements.

The English courts have been willing to incorporate terms into a contract by a prior course of dealing which was both regular and consistent.<sup>751</sup> This incorporation is also possible in verbal contracts when the parties previously had regular contractual relationships.<sup>752</sup> For a specific clause to be implied into the verbal agreement there is a need for it to have been included in several previous contracts.<sup>753</sup> The requirement 'regular' will not be met in the case of only some previous contracts.<sup>754</sup> It is difficult to guess a minimum period of time and number of previous orders which would be sufficient for a court to constitute a 'prior course of dealing', but one can assume that, on the basis of the case law, there ought to be a consistent previous dealing of at least a year with some orders per month.<sup>755</sup> It is therefore likely that in such circumstances courts would be prepared to imply the CSR policy into

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<sup>749</sup> See: I Macneil, 'Reflections on Relational Contract theory after a Neo-classical Seminar', in D Campbell, H Collins and J Wightman (eds), *Implicit Dimensions of Contract* (Hart Publishing 2003) 207 – 217; A Schwartz, 'Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies' (1992) 21 *Journal of Legal Studies* 271, 271.

<sup>750</sup> Important issues which are often discussed in the literature on long-term and relational contracts are the need to allow for flexibility and adjustments of the contracts to changing circumstances. See for an introduction into this topic: M Hviid, 'Long-term contracts and relational contracts', in B Bouckaert and G De Geest (eds), *The Encyclopaedia of Law and Economics vol III* (Edward Elgar 2000) 46.

<sup>751</sup> *McCutcheon v David MacBrayne Ltd* [1964] 1 All ER 430, [1964] 1 WLR 125, HL.

<sup>752</sup> R Austen-Baker, *Implied Terms in English Contract Law* (Edward Elgar 2011) para 5.34.

<sup>753</sup> The party which asks the courts to imply this specific clause would need to provide documentation that the clause had been incorporated into previous contracts.

<sup>754</sup> This situation might be different in commercial contracts where the parties are of equal bargaining power: In *British Crane Hire Corporation Ltd v Ipswich Plant Hire Ltd* [1975] QB 303, a clause was implied in the contract on the basis of two previous transactions and the customs of trade. However, even though one could construe equality of bargaining power due to the commercial nature of both buyer and supplier, it would be too construed to assume an incorporation of CSR policies into such contracts as customs of trade – especially as every company tends to develop its own CSR code of conduct. This case is therefore unlikely to provide any precedent for the scenario discussed here.

<sup>755</sup> It depends on the facts of the particular case what constitutes a 'regular' course of dealing. The Court of Appeal held in *Hollier v Rambler Motors (A.M.C.) Ltd* [1972] 2 Q.B. 71; [1972] 1 All ER 399 that past dealings on three or four occasions over a period of five years is not sufficient to imply a term into a contract by course of dealing between the parties. This case is to be contrasted with the interpretation of 'regular' in *Henry Kendall Ltd v William Lillico Ltd* [1962] 2 AC 31 in which the House of Lords considered three or four dealing per month over a period of about three years as sufficient, which amounts to about a hundred contracts over this period. The threshold of what is 'regular' will be somewhere between these two cases.

subsequent informal agreements (e.g. verbal contracts) which are not as detailed as to provide for the CSR policy of the buyer.

#### **4.3.4 Enforcement against suppliers ‘down the chain’**

As the concerns about lack of corporate social responsibility among firms in transnational economies apply in particular to those contractors at the end of the supply chain, the chapter needs to consider the question of whether the Western company at the ‘head’ of the supply chain could enforce a contract against firms further down the supply chain. In fact, a particular challenge which the supply chain poses for the promotion of CSR through contracts between the buyer and the supplier is that many suppliers use sub-contractors further down the supply chain to provide material or to complete a significant element of the contract.<sup>756</sup> A distinction is therefore often made in the literature on supply chains between different tiers of suppliers to describe this situation: First-tier suppliers, second-tier suppliers and so on.<sup>757</sup> The sub-suppliers are not party to the contract between the buyer and the supplier.

Due to the privity of contract doctrine, it is a general rule that third parties cannot be subjected to a burden by a contract to which they are not a party.<sup>758</sup> Hence, no obligation can be placed upon them.<sup>759</sup> It is considered to be unreasonable to subject a third party to a burden in a contract to which he is not a party.<sup>760</sup> This issue is not regulated by the Contracts (Rights of Third Parties) Act 1999 which instead focusses on the rights of third parties. The Act does not allow enforcement of burdens imposed on third parties.<sup>761</sup> The supply chain contracts between the buyer and their seller can therefore not directly impose a duty on sub-suppliers to adhere to the code of conduct of the multinational company based in the UK. The buyer is therefore unable to sue sub-suppliers further down the supply chain as they are not parties to the contract. As a consequence of this legal situation there is a danger that the suppliers can evade their CSR obligations by employing a number of sub-contractors who do most of the work on their behalf.

However, if the buyer’s general terms and conditions impose a duty on the first-tier supplier to implement the buyer’s CSR policy further down its own supply chain

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<sup>756</sup> A Agrawal, A de Meyer and L van Wassenhovez, ‘Managing Value in Supply Chain - Case Studies on The Sourcing Hub Concept’ 1, available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1888756&](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1888756&) (last accessed 20/6/2012).

<sup>757</sup> *ibid.*

<sup>758</sup> McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.1.

<sup>759</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 11.2.

<sup>760</sup> *ibid.*

<sup>761</sup> *ibid.*, para 11.3.4.

(perpetual clause) then this term constitutes a contractual duty on the supplier to do so. If the first-tier supplier consequently incorporates the buyer's CSR policy into its contracts with its own sub-contractors, then it is able to sue its own contractors for breaches of this policy. If the first-tier supplier fails to incorporate the buyer's CSR policy into its contracts with its own contractors, then this failure constitutes a breach of the first-tier supplier's contractual duties to the buyer. In that case the buyer could sue its first-tier supplier for breach of contract. However, as indicated, the buyer could not directly sue the second-tier supplier to comply with its CSR policies as the second-tier supplier is not party to the contract between the buyer and the first-tier supplier.

The challenge of ensuring the incorporation of CSR obligations by suppliers into their sub-supplier contracts is also addressed in the CSR reports of multinational companies. Statements about the responsibility for the conduct of sub-suppliers are rather cautious as the multinational companies tend to emphasise the duty of their direct (first-tier) suppliers to implement similar CSR policies within their own supply chains. Vodafone, for instance, states that it requires its first level (direct) suppliers to confirm that they will comply with the company's code of ethical purchasing and that it would also 'encourage all suppliers to implement the standards across their whole business and within their own supply chain'.<sup>762</sup> Similarly, Unilever's supplier code states that its direct suppliers are responsible for requiring their direct suppliers [sub-suppliers] to adhere to the principles of the code.<sup>763</sup> However, Unilever does not contain any clause in its terms and conditions or its supplier code which imposes a duty on its suppliers to establish a similar contractual CSR regime with their sub-contractors. In the guidelines to its supplier code, Unilever declares that it is aware of the fact that many of the CSR issues arise further down the supply chain and that first tier suppliers therefore have a responsibility to ensure that the principles are followed there, too.<sup>764</sup> Rio Tinto takes a different approach and expressly prohibits their suppliers to subcontract without its prior written authorisation.<sup>765</sup> More

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<sup>762</sup> Vodafone, *Responsible supply chain*, available at: [http://www.vodafone.com/content/index/about/sustainability/being\\_responsibleethicalandhonest/responsible\\_supplychain.html](http://www.vodafone.com/content/index/about/sustainability/being_responsibleethicalandhonest/responsible_supplychain.html) (last accessed 20/6/2012).

<sup>763</sup> Unilever, *General Terms & Conditions of Purchase of Goods of Unilever Supply Chain Company AG ("Conditions")*; Unilever, *Unilever's Supplier Code*, available at: <http://www.unilever.com/aboutus/purposeandprinciples/supplier-code/> (last accessed 20/6/2012).

<sup>764</sup> Unilever, *Supplier Code Guidelines*, available at: <http://www.unilever.com/sustainability/customers-suppliers/suppliers/guidelines/index.aspx> (last accessed 22/6/2012).

<sup>765</sup> Rio Tinto, *Purchase Order for the Supply of Goods Terms and Conditions*, section 11: "Assignment; Subcontracting: The Supplier shall not assign, delegate, novate, mortgage, charge, sub-let, subcontract or otherwise dispose of the Purchase Order or any interest, rights or obligations hereunder, in whole or in part, including any performance or any amount that may be due hereunder, without the Buyer's prior written authorization."

cautiously, GlaxoSmithKline uses the following term in its terms and conditions of purchase:

Supplier agrees that it is responsible for controlling its own supply chain and that it shall encourage compliance with ethical standards, and human rights by any subsequent supplier of goods and services that are used by Supplier when performing its obligations under the Agreement.<sup>766</sup>

The different examples reflect the legal situation that contractual duties cannot be imposed against third parties who are not party to the contract. The carefully worded clause by GlaxoSmithKline that its suppliers 'shall encourage compliance' within their own supply chain as well as the statement by Vodafone that they ask their suppliers to 'encourage all suppliers to implement the standards...within their own supply chain' are in line with the fact that contractual parties (e.g. the multinational company based in the UK and its direct/first-tier supplier in the developing world) cannot enforce a burden imposed on a third party such as sub-contractors/second-tier suppliers.

Sub-contracting therefore poses a significant challenge for the promotion of CSR policies in the supply chain through contract law, especially if there are diversified suppliers and sub-suppliers. The more parties are involved in the production process, the easier it is that CSR obligations are circumvented, as the Western buyer cannot bind companies further down the supply chain that are not its contractual partners. The ability of contract law to promote corporate social responsibility throughout the supply chain is therefore limited in practice. This situation is a major drawback of using contract law to promote socially responsible behaviour among corporations. However, this drawback can be mitigated if Western companies use their bargaining power to force their suppliers to ensure compliance with CSR standards further down the supply chain. Such a practice might arise due to growing public pressure and the reputational damage that reports about human rights abuses within the supply chain entails.<sup>767</sup>

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<sup>766</sup> GlaxoSmithKline, *Terms and Conditions of Purchase (Goods&Services)*, section 21.2.

<sup>767</sup> The increasing public pressure on multinational companies is evidenced, inter alia, by the recommendation of the UN Guiding Principles on Business and Human Rights that business enterprises should 'seek to prevent or mitigate adverse human rights impacts either through their own activities or as a result of their business relationships with other parties', see Principle 13. The commentary to this Principle emphasises that business relationships are 'understood to include relationships with business partners, entities in its value chain...'. Moreover, the supply chain has been addressed at EU level, as evidenced by a document on responsible supply chain management, published in 2010, which was commissioned under the European Union's Programme for Employment and Social Solidarity - PROGRESS (2007-2013), M van Opijnen and Joris Oldenziel, *Responsible Supply Chain Management, Potential success factors and challenges for addressing prevailing human rights and other CSR issues in supply chains of EU-based companies* (2010), available at: [http://ec.europa.eu/enterprise/policies/sustainable-business/files/business-human-rights/final\\_rscm\\_report-11-04-12\\_en.pdf](http://ec.europa.eu/enterprise/policies/sustainable-business/files/business-human-rights/final_rscm_report-11-04-12_en.pdf) (last accessed: 07/06/2013).

#### 4.3.5 Enforcement of the CSR terms in supply chain contracts by third parties

The incorporation of CSR policies into the supply contract also raises the question of whether third parties such as the supplier's employees are able to enforce the contract between the buyer and its supplier on the basis of the Contracts (Rights of Third Parties) Act 1999. This issue is particularly relevant in relation to the CSR terms in the contract which are potentially beneficial for third parties such as the supplier's employees or the local community.

At common law, the privity of contract doctrine stipulates that parties who are not party to the contract cannot enforce it, even if the contract was specifically entered into for their benefit.<sup>768</sup> However, this situation changed in English law with the Contracts (Rights of Third Parties) Act 1999. The Act was intended to overcome the common law's privity rules which were considered to be unjust and needlessly complex.<sup>769</sup> Section 1 of the Act provides that a person who is not actually a party to the contract may still enforce a term of the contract if he meets the test of enforceability in s1 (1) – (3) of the Act. This test requires that a term of the contract expressly provides that the third party may enforce a right in its own right or that a term purports to confer a benefit on that party.<sup>770</sup> The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.<sup>771</sup> If the third party meets this test, all remedies are available to him that would be available to the parties of the contract.<sup>772</sup> The third party can enforce his rights against the promisor of the term. In a supply contract, the CSR duties are imposed on the supplier. For instance, the promisor of the right of employees to join a trade union is the supplier as their employer.

An express provision pursuant to s1 (1) (a) of the Act is provided if the contracting parties state that the third party 'shall have the right to enforce the contract'.<sup>773</sup> Alternatively, pursuant to s1 (1) (b) of the Act, the third party might derive a right

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<sup>768</sup> R Lawson and S Singleton, *Commercial Contracts: A Practical Guide to Standard Terms* (Tottel Publishing 2006) para A2.94. Authority for this rule can be found in *Dunlop Pneumatic Tyre Co. Ltd v Selfridge & Co Ltd* [1915] AX 847.

<sup>769</sup> Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, No 242 (Cm. 3329, 1996) Part III.

<sup>770</sup> S1 (1) Contracts (Rights of Third Parties) Act 1999. Notably the third party will be able to enforce the term of the contract even though he has not provided any consideration for his right. It is sufficient that the contract is supported by the considerations supplied by the original parties to the contract. It is argued that s1 of the Act is sufficiently clear to confer a right on a third party whether or not he had provided consideration, see E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.7.

<sup>771</sup> S1 (3) Contracts (Rights of Third Parties) Act 1999.

<sup>772</sup> S1 (5) Contracts (Rights of Third Parties) Act 1999.

<sup>773</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.6.

from the supply contract if a contract term purports to confer a benefit on him. This option is applicable if 'on a true construction of the term in question its sense has the effect of conferring a benefit on the third party in question'.<sup>774</sup> In this case, the court did not consider it to be necessary that the predominant purpose or intent behind the term is that the subsection confers a benefit to the third party. On this basis it has been argued that the requirement that the term in question 'purports to confer a benefit' on the third party will not be difficult to meet.<sup>775</sup> Benefits conferred upon third parties in the CSR context could be duties on the supplier not to use child labour, not to make their employees work excessive working hours and to allow employees to join a Union.

In the documents from the companies reviewed for this chapter, there is no term that meets the requirements of s1 (1) (a) of the Act by expressly conferring upon a third party the right to enforce the contract. However, the second way for third parties to acquire an enforceable right in s1 (1) (b), i.e. if a term 'purports to confer a benefit', is more likely to apply and to entitle third parties to enforce CSR clauses. The following provisions of GlaxoSmithKline's terms and conditions are an example of this situation:

...Supplier warrants....:

21.1.2. it does not use forced labour in any form (prison, indentured, bonded or otherwise) and its employees are not required to lodge papers or deposits on starting work;

21.2.5. it does not discriminate against any employees on any ground (including race, religion, disability or gender)

21.1.7. it complies with the laws on working hours and employment rights in the countries in which it operates.

21.1.8 it is respectful of the employees right to join and form independent trade unions and freedom of association...<sup>776</sup>

Upon a true construction of these terms one can argue that the supplier's declaration that it does not use forced labour in any form, that it does not discriminate against any employees on any ground, that it complies with the laws on working hours and employment rights and that it allows its employees the right to join a trade union are intended to confer a benefit on the employees. These exemplary terms provide clear benefits for the employees of the supplier who are also expressly identified as a class, hence meeting the test in s1 (3) Contracts

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<sup>774</sup> *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch); [2007] 3 All ER 946.

<sup>775</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.6.

<sup>776</sup> GlaxoSmithKline, Terms and Conditions of Purchase, section 21: 'Ethical Standards and Human Rights'.

(Rights of Third Parties) Act 1999.<sup>777</sup> Given the court's rather broad interpretation of 'purports to confer a benefit' on the third party, one can conclude that in this example the employees of the supplier acquire an enforceable right due to s1 (1) (b) of the Act. The contractual obligations to comply with the laws on working hours, to grant its employees the right to join a trade union, not to discriminate on any ground and not to use forced labour in any form are imposed on the supplier as the promisor of these duties. Hence, in the example here, the third parties, the employees, are provided with a right of action against the supplier, their employer, due to the Contracts (Rights of Third Parties Act) 1999.

However, the parties to the contract can expressly make clear that they do not intend to confer a right of action on a third party.<sup>778</sup> The contracting parties are allowed to exclude the conferment of a right of action upon third parties.<sup>779</sup> Section 1 (1) (b) is then disapplied by s1 (2) of the Act.<sup>780</sup> Where the parties indicate in the contract that they do not intend to confer an enforceable benefit upon a third party with the contract, the right that third parties might acquire from s1 (1) (b) Contracts (Rights of Third Parties) Act 1999 will not apply. The contractual parties are able to exclude the application of the Contracts (Rights of Third Parties) Act 1999 by third parties without the danger that this exclusion is considered to be an unfair term. The reason is that the supply contracts discussed here are exempt from the usual test for exclusion clauses pursuant to the Unfair Contract Terms Act 1977. S7 (4) of the Contracts (Rights of Third Parties) Act stipulates that s1 would not allow a third party to be treated as a contracting party for the purposes of any other Act. This includes the Unfair Contract Terms Act whose s3 test for exclusion or restriction of liability therefore does not apply if the buyer and supplier exclude the rights of third parties to enforce a term of the Act. Moreover, as indicated above, the Unfair Contract Terms Act 1977 does not apply to international sale of goods contracts.<sup>781</sup>

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<sup>777</sup> McKendrick uses the example of a contract between A and B which extends a warranty given to A also to subsequent owners and / or tenants of a building. Employees are as identifiable as a group here and it can therefore be assumed that they would be classified as a member of a class. See E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.6.

<sup>778</sup> S1 (2) Contracts (Rights of Third Parties) Act 1999. See also A Burrows, 'The Contracts (Rights of Third Parties) Act 1999 and its implications for commercial contracts' [2000] *LMCLQ*. 540, 545; E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 7.6.

<sup>779</sup> N Andrews, 'Strangers to justice no longer: the reversal of the privity rule under the Contracts (Rights of Third Parties) Act 1999' (2001) 60 *Cambridge Law Journal* 353, 373.

<sup>780</sup> T Roe, 'Contractual Intention under Section 1(1)(b) and 1(2) of the Contracts (Rights of Third Parties) Act 1999' (2000) 63 *MLR* 887.

<sup>781</sup> S26 (3) (b) Unfair Contract Terms Act 1977. International supply contracts are defined as (a) being either a contract of sale of goods or being a contract under or in pursuance of which the possession or ownership of goods passes; and (b) it is made by parties whose places of business are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom). Moreover, a contract falls into this category only if either a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried,



And, in fact, the terms and conditions of GlaxoSmithKline which have just been analysed in terms of providing rights to third parties also contain a term excluding the rights of third parties:

25.8. Except for any rights granted to GSK Affiliates, which the parties hereby designate as intended third party beneficiaries to the Agreement, no person who is not a party to the Agreement shall have any rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term.<sup>782</sup>

The terms and conditions of the other companies reviewed for this chapter all contain similar provisions such as the following clause in Rio Tinto's terms and conditions:

No person who is not a party to the relevant contract or the Purchase Order shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of the Purchase Order.<sup>783</sup>

In actual fact, this exclusion of the rights of third parties is standard practice in commercial contracts<sup>784</sup> and it is therefore included in the model purchase agreements:

Third parties: For the purposes of the Contracts (Rights of Third Parties) Act 1999 this Agreement is not intended to, and does not, give any person who is not a party to it any right to enforce any of its provisions.<sup>785</sup>

During the consultation process that led to the introduction of the Act, the Law Commission did not consider the easy exclusion of the rights of third parties to enforce terms that purport to confer a benefit on them to be problematic.<sup>786</sup> The discussions rather focused on the question whether or not the introduction of s1 (1) (b) would result in 'uncertainty'.<sup>787</sup> It was argued that the rebuttable presumption of enforceability for third parties would achieve a 'satisfactory compromise'.<sup>788</sup> However, the fact that the parties can relatively easily exclude the applicability of s1 (1) (b) of the Contracts (Rights of Third Parties) Act 1999 severely limits the power

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from the territory of one State to the territory of another; or b) the acts constituting the offer and acceptance have been done in the territories of different States or c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

<sup>782</sup> GlaxoSmithKline, Terms and Conditions of Purchase, section 25: 'General'.

<sup>783</sup> Rio Tinto Purchase Order for the Supply of Goods Terms and Conditions, section 12, Third Parties Excluded.

<sup>784</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 11.3.4.

<sup>785</sup> Section 21.12.

<sup>786</sup> See Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, No 242 (Cm. 3329, 1996) para 7.18 (iii).

<sup>787</sup> *ibid.*

<sup>788</sup> *ibid.*, para 7.17.

of the supply contracts to promote corporate social responsibility among firms. The third parties, as the beneficiaries of the contractual CSR clauses, can acquire rights through s1 (1) (b) Contracts (Rights of Third Parties) Act that they then lose due to the standard exclusion of this Act. Viewed from their perspective, the compromise found in the Act is contradictory. It can be argued that contractual parties who promise to benefit third parties in a contract (through contractual CSR clauses) should expect to have these promises enforced by these third parties such as the employees of GlaxoSmithKline's suppliers in the example used above. This argument can be supported by the fact that the legislator expressly enabled third parties such as the supplier's employees to acquire a right if a contractual term purports to confer a benefit upon them and where they are identified as a member of a class (e.g. the employees of GlaxoSmithKline's suppliers). Otherwise, contractual terms that pretend to enhance the position of third parties would only be general statements whose enforcement purely depends on the buyer and not on the intended beneficiaries themselves. At the moment, contract law can therefore be used as a tool to make public CSR commitments by entering into contractual CSR obligations that the intended beneficiaries, the third parties, are unable to enforce.

The current legal position means that the Contracts (Rights of Third Parties) Act 1999 has not significantly improved the situation of third parties as the intended beneficiaries of a greater socially responsible commitment of corporations. Quite the contrary, the possibility for the contractual parties to exclude the applicability of s1 (1) (b) of the Act contradicts the aim of the Act, namely to provide third parties with a right of enforcement. Third parties, such as the suppliers' employees that are expressly identified in a contractual clause, should have a right to enforce clauses that are beneficial for them, for example the right to join a trade union or not be forced to work excessive hours. Whilst this contradiction in the Act is criticised, it is important to point out that it is still the contractual parties who choose to exclude the applicability of s1 (1) (b) Contracts (Rights of Third Parties) Act 1999 (and hence the enforcement of their CSR policies by the intended beneficiaries of these policies) in the first place.

#### **4.4 What remedies are or could be available for breach of CSR terms?**

Once the buyer's CSR policy has become part of the supply contracts, the next issue in terms of promoting the socially responsible conduct of corporations is if the buyer (the Western company) is able to procure an appropriate remedy in contract law for the breach, i.e. repudiation rather than damages. Repudiation of the contract is a particularly strong remedy as it provides the non-breaching party with the right

to terminate further performance of the contract whereas the right to damages gives the innocent party a right to recover damages in respect of the loss suffered from the breach. The consequence of a right to terminate the contract is severe for suppliers as they can lose the contract with the buyer. This situation means that, if the buyers procure the right to terminate the contract rather than the right to claim damages for a breach of the CSR terms, then the socially responsible behaviour of the suppliers is given a particularly strong position through contract law.

The following section will analyse what remedies the buyers could procure for breaches of some of the contractual CSR clauses from the documents that were researched for this chapter. It is beyond the scope of this chapter to analyse all material found on the websites. The analysis will therefore rather focus on a small sample of companies which have provided their contractual documents such as their general terms and conditions for purchase order forms. The three companies selected are Rio Tinto, Unilever and GlaxoSmithKline.<sup>789</sup> The contractual terms pertaining to CSR in the terms and conditions of these three companies are the object of the following analysis. There is, so far, no case law available that deals with the breach of CSR principles in supply contracts.

The kind of remedy which is available to the Western buyer here depends on the type of term which is broken.<sup>790</sup> The three types of terms are conditions, warranties and innominate terms.<sup>791</sup> A condition is an essential term of the contract which goes to the root or the heart of the contract (e.g. in case of the purchase of a new car these are the terms as to the make of the car).<sup>792</sup> Conditions contain the main obligations and are central to the contract.<sup>793</sup> If a condition is broken, the breach is generally considered as repudiatory and the non-breaching party has the option of either terminating the contract for the future and to obtain damages for any loss suffered or affirming it and to recover damages for the breach.<sup>794</sup> A warranty is a lesser, subsidiary term of the contract (e.g. the colour of the car).<sup>795</sup> A breach of a warranty is not a repudiatory breach and the non-breaching party can only obtain

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<sup>789</sup> Rio Tinto, *Purchase Order for the Supply of Goods, Terms and Conditions*; Unilever, *General Terms & Conditions of Purchase of Goods of Unilever Supply Chain Company AG ("Conditions")*; GlaxoSmithKline, *Terms and Conditions of Purchase*.

<sup>790</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 8.5.

<sup>791</sup> *ibid.*

<sup>792</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 10.1.

<sup>793</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 8.5.2.1.

<sup>794</sup> *ibid.*, para 8.5.3.

<sup>795</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 10.1. S61 of the Sale of Goods Act 1979 defines warranties in the following way: "warranty" (as regards England and Wales and Northern Ireland) means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.'

damages, but not terminate or affirm.<sup>796</sup> Between these two types are innominate terms (also called 'intermediate terms'). They were introduced in *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*<sup>797</sup> as it was considered to be inflexible that breaches of contractual terms give only either rise to a termination or to damages depending on the classification of the terms.<sup>798</sup> Innominate terms are terms which cannot be categorised as being conditions or warranties, as they can be broken in a way that is so fundamental that it undermines the whole purpose of the contract (i.e. giving rise to repudiation) or in a way that is rather trivial and where, consequently, damages are an adequate remedy.<sup>799</sup> The assessment of the question if a breach of an innominate term gives rise to repudiation depends on the issue whether or not the nature of the breach deprives the non-breaching party of substantially the whole benefit of the contract.<sup>800</sup> The breach is repudiatory if the legal benefit of the contract has been removed from the non-breaching party. If it is repudiatory, then the non-breaching party has the right to terminate the contract, as in case of a breach of a condition. Innominate terms therefore give the courts greater remedial flexibility to focus on the consequences of the breach.<sup>801</sup> In essence, when assessing the type of a term, one must consider its 'commercial significance' for the contract as a whole.<sup>802</sup> It is therefore necessary to decide if the breach deprives the non-breaching party of substantially the whole benefit of the contract. It can be difficult to ascertain how serious the consequences of the breach must be before an innocent party is entitled to terminate.<sup>803</sup> The factors that courts include in their decision about the seriousness of a breach are, inter alia, the losses caused by the breach, the cost of making performance comply with the terms of the contract and the adequacy of damages as a remedy to the innocent party.<sup>804</sup> The decision depends on the facts of the individual case and on the effects of the breach.<sup>805</sup> It can, however, be difficult for courts to make this decision when a term

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<sup>796</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 8.5.2.1.

<sup>797</sup> [1962] 2 QB 26.

<sup>798</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 8.5.5.

<sup>799</sup> E McKendrick, *Contract Law: Text, Cases and Materials* (4th edn, OUP 2010) 783.

<sup>800</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 8.5.5.3.

<sup>801</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 10.5.

<sup>802</sup> *State Trading Corporation of India Ltd v Golodetz Ltd* [1989] 2 Lloyd's Rep 277, 283.

<sup>803</sup> E McKendrick, *Contract Law: Text, Cases and Materials* (4th edn, OUP 2010) 783.

<sup>804</sup> *ibid.*

<sup>805</sup> In *Bunge Corporation New York v Tradax Export SA* [1981] 1 WLR 711 which concerns a contract that incorporates standard terms it was criticised that the classification of terms as innominate terms potentially resulted in uncertainty as it is necessary to await the consequences of the breach first. In this case the court said that 'certain contractual terms, especially those agreed by the parties to give rise upon any breach to a right to treat the contract as repudiated, were not amenable to being classified as innominate terms.'

has not previously been classified.<sup>806</sup> Innominate terms have therefore enjoyed a mixed reception in the case law.<sup>807</sup>

Another remedy which would promote CSR is specific performance. An order of specific performance is a remedy for breach of contract which compels the obligor to actually perform the agreed obligation rather than being exposed to a termination of the contract or having to pay damages as compensation for the breach.<sup>808</sup> However, whereas damages are available as a right upon breach of contract, the remedy of specific performance is only rarely awarded in English law.<sup>809</sup> It is an equitable remedy which is only available in the discretion of the courts.<sup>810</sup> Specific performance is traditionally regarded by the courts as a supplementary remedy which is only granted when damages are inadequate.<sup>811</sup> The scope of the specific performance remedy has been broadened in *Beswick v Beswick*<sup>812</sup> which held that specific performance could be awarded upon the basis of appropriateness rather than as a supplementary remedy. However, it is the duty of the non-breaching party to demonstrate that damages would be an inadequate remedy.<sup>813</sup>

Applying these principles to the companies chosen here, the first example is Rio Tinto:

#### 10. Compliance with law and policies

In supplying the Goods and associated services (if any), the Supplier will:... (b) comply with Rio Tinto's policy titled "The Way We Work" that can be found at <http://...>

The contractual term in section 10 (b) of the terms and conditions stipulates compliance with the company's code of conduct. The code of conduct 'The Way We

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<sup>806</sup> McKendrick, *Contract Law: Text, Cases and Materials* (4th edn, OUP 2010) 784.

<sup>807</sup> In *Maredelanto Compania Naviera SA v Bergbau-Handel GmbH (The Mihalis Angelos)* [1971] 1 QB 164 which was decided after *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* the Court of Appeal classified the clause 'expected ready to load under this charter about 1 July 1965' as a condition and not as an innominate term. However, in *Cehave NV v Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1976] QB 44 the Court of Appeal classified the clause 'Shipment to be made in good condition...each shipment shall be considered a separate contract' to be an innominate term. The court stated that the classification of this clause as a condition would enable the buyers to reject the contract even in case of small-scale deviations. However, in the court's opinion 'buyers should not have a right to reject the whole cargo unless [the deficiency] was serious and substantial.' See for an overview of this discussion: E McKendrick, *Contract Law: Text, Cases and Materials* (4th edn, OUP 2010) 783–794.

<sup>808</sup> J Poole, *Textbook on Contract Law* (9<sup>th</sup> edn, OUP 2012) para 10.2.

<sup>809</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 21.9.

<sup>810</sup> *ibid.*

<sup>811</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 10.2.

<sup>812</sup> *Beswick v Beswick* [1968] AC 58. However, it is argued that the more recent decision of the House of Lords in *Co-operative Ins Society Ltd v Argyll Stores Ltd* [1998] A.C.1 indicates a return to a more restrictive approach of the courts to the granting of specific performance as a remedy.

<sup>813</sup> J Poole, *Textbook on Contract Law* (9<sup>th</sup> edn, OUP 2012) para 10.2.1.

Work'<sup>814</sup> is a reference document. It is not part of the term itself. However, it is a point of reference to determine whether or not the supplier is in breach of his binding contractual commitment pursuant to section 10 (b) which is to be in compliance with the code. The code contains a variety of principles, for example, about the environment, human rights and bribery. The main purpose of the contract is supply and purchase. The issues addressed in the code do not address the main obligations of the contract of sale of goods such as payment and delivery, but they establish a duty on the supplier to adhere to a range of CSR principles. Therefore the term in section 10 (b) cannot be classified as a condition. However, given the significance of some of the principles in the code for the reputation of the buyer or, in case of bribery, potentially also for its liabilities, it would not be appropriate to classify the term as a warranty either as this would only entitle the buyer to damages, but not to termination in case of a breach of the term. The breach of this term can therefore be so severe that it undermines the purpose of the contract or it can occur in a way that is comparatively trivial. It therefore appears suitable here to classify the term as an innominate term. The reason for this classification is that otherwise, once classified, all breaches of the term would either only entitle Rio Tinto (the buyer) to damages (in case of a warranty) or would always entitle the company to termination (in case of a condition), even in case of trivial breaches. Given the diversity of the principles which are covered by the contractual term in question, it is preferable to have the flexibility which is offered by innominate terms. For example, Rio Tinto's principles on bribery in its code are strict: 'Rio Tinto prohibits bribery and corruption in all forms, whether direct or indirect.'<sup>815</sup> Pursuant to s7 of the Bribery Act 2010, Rio Tinto as a commercial organisation could be guilty of the offence of failing to prevent bribery by a person associated with it.<sup>816</sup> The associated person can be an employee, agent, subsidiary or supplier.<sup>817</sup> Pursuant to

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<sup>814</sup> Rio Tinto, *The way we work: Our global code of business conduct*, (December 2009), available at: [http://www.riotinto.com/documents/The\\_way\\_we\\_work.pdf](http://www.riotinto.com/documents/The_way_we_work.pdf) (last accessed 24/6/2012).

<sup>815</sup> *ibid*, section 'Bribery and corruption', 19.

<sup>816</sup> Pursuant to s7 (2) of the Bribery Act it is a defence for a commercial organisation to prove that it had in place adequate procedures designed to prevent persons associated with it from undertaking such conduct. Pursuant to s9 (1) of the Act the Secretary of State must publish guidance about procedures that relevant commercial organisations can put in place to prevent persons associated with them from bribing as mentioned in section 7 (1). The Ministry of Justice published the Guidance in March 2011. The Guidance, *inter alia*, recommends companies to use of anti-bribery terms and conditions in their supply contracts, see: Ministry of Justice, *The Bribery Act 2010: Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)*, (March 2011) para 39, available at: <https://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf> (last accessed: 07/06/2013).

<sup>817</sup> S8 Bribery Act 2010. S8 (3) stipulates that 'associated person' may (for example) be an employee, an agent or subsidiary. The list is non-exhaustive, as indicated by 'for example'. Suppliers are generally considered to constitute an 'associated person' for the purpose of ss7, 8 of the Act. This understanding is outlined, for example, in the government's guidance how commercial organisations can prevent bribery committed by persons associated with them. See Ministry of Justice, *The Bribery Act 2010*:

s11 (3) of the Act, commercial organisations, if convicted, are liable to pay a fine. One could therefore argue that the potential consequence of a breach of this principle (inter alia liability under the Bribery Act 2010) can be of such commercial significance that it undermines the purpose of the contract. In serious cases (where the buyer might face a higher fine, if convicted) the breach of the principle not to commit bribery could, consequently, deprive Rio Tinto of the benefit of the contract. Although the breach does not affect the primary object of the contract, i.e. supply and purchase, it can be argued that the potential liability that Rio Tinto could incur under the Bribery Act 2010 would justify classifying the breach as repudiatory in serious cases of bribery. Damages would then not be an appropriate remedy. In that case, the breach of the innominate term in Rio Tinto's terms and conditions could provide the buyer with the right to repudiation. However, it is likely that not every case of bribery by a supplier would provide the buyer with a right to repudiation, as the courts consider each breach of an innominate term in terms of its seriousness. Due to this flexibility of the courts it is difficult to predict under what circumstances breaches will be classified as repudiatory. Among the factors that the courts take into account when making that decision is the losses caused by the breach. The higher the potential fine due to the seriousness of the bribery, the more likely it will be that the breach will be considered as being repudiatory. In contrast, less severe cases of bribery will probably only give rise to damages.

The situation differs in terms of the other principles, for example the principle not to use forced or child labour.<sup>818</sup> If the supplier is found to be in breach of this principle, then this human rights violation is likely to have a significant negative impact on the reputation of Rio Tinto. However, despite the reputational damage that the use of forced or child labour entails for the Western buyer, Rio Tinto would not be deprived of the economic benefit of the supply contract. As will be shown in the chapter on tort law, where Rio Tinto's suppliers or subsidiaries commit torts (e.g. by abusing human rights), they will usually be liable themselves rather than Rio Tinto. Rio Tinto would therefore rather face reputational damage than legal liability. Consequently, despite the significant reputational damage that human rights abuses can entail, it is likely that the breach of the innominate term here would result in the remedy of damages. In commercial practice, it is probable that Rio Tinto would not enter into new supply contracts with that supplier, following such a breach.

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*Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)*, (March 2011), available at: <https://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf> (last accessed: 07/06/2013).

<sup>818</sup> Rio Tinto, *The way we work: Our global code of business conduct*, (December 2009), Section 'Employment', 12.

A clearer example of a breach that is likely to give rise to damages only is the following principle: 'forbid using inappropriate language in the workplace, including profanity, swearing, vulgarity or verbal abuse'.<sup>819</sup> Notably, this principle falls under the same heading as the prohibition of child labour and forced labour, namely 'employment' and it is only two bullet points away from these aspects. However, where the supplier is found to be in breach of this principle, it would not deprive the buyer of the economic benefit of the contract. In particular, the reputational risk vis-à-vis the customer is likely to be limited. It would therefore not seem to be proportional to treat such a breach as repudiatory.

These different examples – bribery, child/forced labour and the use of inappropriate language at the workplace – illustrate well the different situations which can lead to a breach of the term referring to CSR in Rio Tinto's terms and conditions. It depends on the facts if a breach of the term ought to be treated as repudiatory or not. The assessment of that issue depends on the question of whether the breach deprives the non-breaching (i.e. here the Western buyer) of the legal benefit of the contract. The classification of the term as an innominate term provides sufficient flexibility for the assessment of breaches of that contractual term. The remedies that Rio Tinto would obtain in case of breaches of the above examples are appropriate. However, the fact that serious cases of bribery by the supplier are likely to be considered to be repudiatory whereas the breaches of the other CSR duties are more likely to result in damages only suggests that legal liability (here through the Bribery Act 2010) in the home states of Western buyers enhances the position of CSR in supply contracts. The duty pertaining to bribery is, consequently, worded in a firm and verifiable manner.

Unilever, too, refers to its code of conduct in its terms and conditions:

### 13. Business Partner Code

Each Supplier and the Lead Supplier acknowledges that it has reviewed Unilever's Business Partner Code (the "Code") and agrees that all of their activities shall be conducted in accordance with the code...The Code can be accessed at the internet address: [www....](http://www.unilever.com/images/USCCAGGeneralTermsConditionsofPurchasetcm13272811.pdf)<sup>820</sup>

As with Rio Tinto, the code is not incorporated, it is a reference document. It is therefore a point of reference to determine whether or not the supplier is in breach of its contractual commitment, i.e. the term in section 13 of Unilever's terms and

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<sup>819</sup> *ibid.*

<sup>820</sup> Unilever, *General Terms & Conditions of Purchase of Goods of Unilever Supply Chain Company AG ("Conditions")*, section 13, available at: <http://www.unilever.com/images/USCCAGGeneralTermsConditionsofPurchasetcm13272811.pdf> (last accessed: 24/6/2012).



conditions. Failure to comply with the principles of Unilever's Business Partner Code ('shall be conducted in accordance with the code') may therefore give right to a repudiatory breach depending on the classification of the term. The breach of the code is again a point of reference when determining what remedy the buyer procures. Unilever's code of conduct is to be read in conjunction with its supporting guidelines.<sup>821</sup> With its reference to the code of conduct the term is again difficult to classify as either a condition or warranty, as the code contains a diverse list of principles ranging from the prohibition of bribery to environmental issues. It is therefore preferable to classify the term here as an innominate term. The principle pertaining to bribery is again strict ('There will be no payments,...') as is the principle that prohibits the use of child labour ('There shall be no use of child labour,...'). Based on the assessment of Rio Tinto's terms and conditions, it can be argued that the situation is similar for the prohibition of bribery and the use of child labour. Whilst a breach of the principle not to use child labour would entail a significant reputational damage, Unilever would not be deprived of the economic benefit of the contract with their suppliers per se. In contrast, it can be argued that the situation is different in serious cases of bribery due to the possible fines under the Bribery Act 2010. A breach of this principle could therefore be seen as undermining the purpose of the contract and hence give right to repudiation. However, the court will assess every case of bribery on its facts in order to determine whether or not it is repudiatory. It is therefore probably that less severe cases of bribery will give rise to damages only.

The situation is again different in terms of the environment as the relevant principle is rather openly phrased ('Operations will be carried out with care for the environment and will include compliance with all relevant legislation in the country concerned'). As environmental standards in the developing world are often rather weak the reference to the local law does not necessarily entail any duties for the supplier that he must adhere to. The phrase 'care for the environment' is rather indefinite which means that the principle is relatively easy to fulfil. This principle is therefore weaker than the mentioned principles on bribery and the use of child labour. Moreover, even if the supplier is found to be in breach with the relevant legislation of the country concerned, it is unlikely that this breach would deprive Unilever of the economic benefit of the contract. Therefore, in terms of breaches of the principle relating to the environment, Unilever would, if at all, only procure a right to damages.

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<sup>821</sup> Unilever, Supplier Code Guidelines.

The third company whose terms and conditions are analysed is GlaxoSmithKline. This company has taken a different approach. Instead of referring to its code of conduct, GlaxoSmithKline has expressly stipulated several CSR obligations upon the supplier in its terms and conditions:<sup>822</sup>

#### 21. Ethical Standards and Human Rights

21.1. Unless otherwise required or prohibited by law, Supplier warrants, to the best of its knowledge, that in relation to the supply of Goods or Services under the terms of the Agreement:

21.1.1. it does not employ, engage or otherwise use any child labour...

21.1.2. it does not use forced labour in any form...

21.1.3. it provides a safe and healthy workplace, presenting no immediate hazards to its employees...

21.1.8. it is respectful of its employees right to join and form independent trade unions and freedom of association; and

21.1.9. it complies with the GSK Anti-Bribery and Corruption Requirements set out in Annex A.

21.2. Supplier agrees that it is responsible for controlling its own supply chain and that it shall encourage compliance with ethical standards and human rights by any subsequent supplier of goods and services...

21.3. Supplier shall ensure that it has ethical and human rights policies and an appropriate complaints procedure to deal with any breaches of such policies.

These extracts show that GlaxoSmithKline has incorporated into its terms and conditions those aspects of socially responsible corporate behaviour that it requires from its supplier. The differentiation into several sub-points of section 21 allows classifying all the terms individually. The fact that the supplier 'warrants' does not anticipate any classification of all the subsequent terms as warranties as it does not denote the terms as 'warranties' and as courts are not bound by the way parties have classified terms.<sup>823</sup> Several terms are strictly worded and breaches of them might be easy to prove. This assessment applies, for example, to the use of child labour and forced labour as well as the right to join or form a trade union and the compliance with GlaxoSmithKline's anti-bribery requirements. Although these principles are firm and verifiable, they do not contain the main obligations of the contract which are supply and purchase. Due to the range of possible breaches of

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<sup>822</sup> GlaxoSmithKline, *Terms and Conditions of Purchase*.

<sup>823</sup> The word used here in the terms and conditions is the verb 'to warrant', but the contractual term itself does not stipulate that the following are 'warranties'. Moreover, although the parties own classification of the contractual terms is one method of classification, it is not conclusive evidence that the parties intended to use the word in such a way. See *Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235.

these terms, it would again be preferable to treat them as innominate terms rather than conditions or warranties. As with Rio Tinto and Unilever, it can be argued that serious breaches of the principle referring to bribery would deprive GlaxoSmithKline of the commercial benefit of the contract due to the potential liability under the Bribery Act. Such breaches could therefore be seen as repudiatory. However, as indicated above, given the flexibility that the courts have, it is likely that less severe cases of bribery will rather be considered to give right to damages only. Whilst breaches of the term prohibiting the use of child or forced labour would entail significant reputational damage, they would not deprive GlaxoSmithKline of the commercial benefit of the contract. The company would therefore procure the right to damages in case of a breach of these terms. In any case, GlaxoSmithKline might also be able to base a termination right on its terms and conditions which it incorporates into the supply contracts, as a clause in the terms and conditions allows either party to terminate the agreement in the case that the other party is in breach of the agreement and does not remedy the breach within 30 days of notice from the other party.<sup>824</sup>

GlaxoSmithKline's terms and conditions confirm the previous finding that employee rights and anti-bribery clauses tend to be given a particularly strong position by the buyer as they are usually firm and verifiable. However, none of the express terms referring to CSR in GlaxoSmithKline's terms and conditions establishes a principle about the protection of the environment. The fact that this company does not even refer to its third party code<sup>825</sup> in its terms, but rather requires its suppliers to have their own ethical and human rights policies, makes environmental considerations more or less optional. They are given a much lower standing than employee rights and bribery and appear to be a minor consideration.

Given the traditionally restrictive approach of the courts to granting specific performance, it is difficult to foresee if courts would grant this remedy in the three cases just analysed. It also depends on the buyer if he seeks an order of specific performance since the breach has already occurred by the time a remedy is sought. The buyer's reputation might therefore have already been damaged which could make the buyer prefer a termination of the contract or damages.

Bringing the analysis of the three companies together, it appears as if there is a hierarchy of CSR issues in the various documents reviewed. It is noticeable that the wording related to bribery is particularly strong. Bribery is therefore at the stronger

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<sup>824</sup> GlaxoSmithKline, *Terms and Conditions of Purchase*, section 22.1 'Termination'.

<sup>825</sup> GlaxoSmithKline, *Third Party Code of Conduct*.

end of the continuum. This view is supported by the fact that GlaxoSmithKline even has a detailed Annex A about bribery which is referred to in the terms and conditions.<sup>826</sup> It is evident that the company deals in greater detail with bribery than with its other CSR policies. The policies of the other companies (Rio Tinto and Unilever) are similarly strict regarding bribery. It is likely that the strong stance taken by the companies on bribery is influenced by the Bribery Act 2010 which, inter alia, creates under certain circumstances an offence for commercial organisations.<sup>827</sup> Domestic statutory provisions therefore seem to have an impact on the use of supply chains to promote CSR. Moreover, it can be argued that serious cases of bribery are repudiatory as the buyer can incur a fine for the committing of bribery by its suppliers. However, the buyer might only procure a right to damages in less severe cases of bribery, but that decision depends on the court.

In contrast, breaches of the principles relating to the use of child labour and forced labour are, despite the strict wording of these clauses, unlikely to result in a right to repudiation. The reason for this assessment is that such breaches would not deprive the buyer of the purpose of the contract, regardless of the reputational damage. The buyer would therefore procure a right to damages in case of a breach. Still, although not English law, the recently introduced Californian Transparency in Supply Chains Act of 2010<sup>828</sup> shows how domestic statutory requirements can influence the use of the supply chain to promote CSR, including UK multinational companies, in terms of forced labour. The Californian Act requires retail sellers and manufacturers to disclose their efforts to combat slavery and human trafficking and to eliminate it from their direct supply chains.<sup>829</sup> The Californian Act might have an impact on some UK multinational companies, too, as all retail sellers and manufacturers that do business in California and that have annual worldwide gross receipts that exceed one hundred million dollars fall within the scope of the Act's disclosure requirements.<sup>830</sup> Shell, for instance, has therefore published a note about its compliance with this Act on its website.<sup>831</sup> This Act is another example of how domestic law can influence the use of the supply contracts for promoting CSR by imposing liabilities or duties for the

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<sup>826</sup> GlaxoSmithKline, *Terms and Conditions of Purchase, Annex A GSK Anti Bribery and Corruption Requirements*.

<sup>827</sup> Section 7, Failure of commercial organisations to prevent bribery: (1) A relevant commercial organisation ("C") is guilty of an offence under this section if a person ("A") associated with C bribes another person intending — (a) to obtain or retain business for C, or (b) to obtain or retain an advantage in the conduct of business for C.

<sup>828</sup> The Act is available at: [http://leginfo.ca.gov/pub/09-10/bill/sen/sb\\_0651-0700/sb\\_657\\_bill\\_20100930\\_chaptered.html](http://leginfo.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.html) (last accessed 15/07/2012).

<sup>829</sup> Section 3 of the California Transparency in Supply Chains Act of 2010.

<sup>830</sup> Section 3 of the California Transparency in Supply Chains Act of 2010.

<sup>831</sup> [http://www-static.shell.com/static/products\\_services/downloads/suppliers/california\\_transparency\\_disclosure.pdf](http://www-static.shell.com/static/products_services/downloads/suppliers/california_transparency_disclosure.pdf) (last accessed 02/07/2012).

Western buyers. It is therefore noticeable that the CSR issues which are dealt with in the strictest manner in the supply chain contracts are addressed by domestic regulation.<sup>832</sup> In comparison to the issues of bribery and forced labour, however, it is doubtful if the buyer procures a remedy for environmental pollution at all, given that the respective provisions about the environment, for example in Unilever's code of conduct are rather openly worded and, in case of GlaxoSmithKline, not even included in an express list of CSR obligations in the company's terms and conditions. The comparison between the issues of bribery, forced and child labour as well as environment matters indicates that there is a difference in the way these aspects of CSR are addressed.

In conclusion, the buyer can procure an appropriate remedy for several violations of its CSR principles due to the classification of the CSR clauses as innominate terms which allows for flexibility based on the particularities of the case. However, the question of whether the buyer can procure a remedy at all depends on the question of how firmly and verifiably the respective CSR principle is phrased. In the examples analysed here the buyers are likely to procure a right to repudiation for the committing of bribery by their suppliers. However, the use of forced or child labour will only give right to damages. The situation is again different for environmental protection, as it will often be difficult to establish a breach of CSR principles referring to the environment in the first place.

#### **4.5 The buyer's awareness of breaches**

Finally, the Western companies (the buyers) must be sufficiently aware of breaches of the terms to at least consider using contract law to promote socially responsible behaviour among their suppliers. Entitlements to use contract law to encourage or require compliance with CSR obligations are useless in practice if the buyer is unaware of a lack of compliance. This part of the chapter will therefore analyse how buyers can monitor the supplier's compliance with their CSR obligations.

Monitoring serves two purposes: First, it signals the buyer's commitment to CSR to the public and it adds legitimacy to the buyers' efforts. Secondly, it is an attempt to ensure compliance of the supplier with the CSR provisions.<sup>833</sup> Monitoring systems can be divided into internal and external systems.<sup>834</sup> Internal monitoring is

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<sup>832</sup> As regards the Californian Act, it is important to note that it only applies to those companies which do business in California and whose income exceeds the threshold, as in the case of Shell.

<sup>833</sup> D Boyed et al., 'Corporate Social Responsibility in Global Supply Chains: A Procedural Justice Perspective' (2007) 40 *Long Range Planning* 341, 344.

<sup>834</sup> I Mamic, 'Managing Global Supply Chain: The Sports Footwear, Apparel and Retail Sectors' (2005) 59 *Journal of Business Ethics* 81, 95.

undertaken by internal staff of the buyer or even by the staff of the supplier who conduct self-audits to assess their own performance. External monitoring or third party auditing describes the practice of using consultants external to an organisation to conduct the audits. The process of monitoring the supplier's site through a visit can usually be broken down into a physical inspection of the supplier factory, a documentation inspection and interviews with workers.<sup>835</sup>

Self-auditing still seems to be a popular tool in practice, perhaps because of the high number of suppliers which many Western companies have. It facilitates the auditing process for them and reduces the cost of monitoring. Unilever, for instance, operates a system where existing suppliers must complete an online questionnaire and renew their information annually. The system is operated by a third party administrator. This system is a mixture of self-auditing by the supplier with external review of the data by a third party. Several companies (e.g. M&S) operate a combination of self-audits, third party and their own audits of the supplier to assess supplier performance. A further tool of self-auditing applied by the companies reviewed for this chapter is a system of pre-contractual checks of potential suppliers. For instance, Vodafone and Shell operate a qualification process to identify potential risks. The emphasis of the regimes is on the filling in of online questionnaires and the providing of documents by the potential suppliers themselves, so it is questionable how objective the system is and if any supplier is turned away at all.

Third party auditing by global accounting firms and non-profit organisations has increased in recent years, partly because self-auditing was increasingly criticised for not being objective enough as staff from the companies themselves conduct the monitoring.<sup>836</sup> As third-party auditors are independent from the suppliers, these audits can be more objective than self-auditing and can help the buyer to become aware of breaches in his supply chain more quickly. However, accounting firms which conduct such third party audits have been found to exercise their role inadequately due to a lack of training about how to detect instances of non-compliance with CSR codes.<sup>837</sup> They have also often asked the factory manager to select the workers for the interview instead of randomly choosing workers themselves in order to possibly get a wider range and more objective views. As multinational companies tend to develop their own CSR code of conduct, third party auditors have to deal with a variety of different CSR codes of conduct which makes

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<sup>835</sup> *ibid*, 96.

<sup>836</sup> R Locke, F Qin and A Brause, 'Does Monitoring Improve Labor Standards? Lessons From NIKE' (2007-2008) 61 *Industrial and Labor Relations Review* 3, 5.

<sup>837</sup> *ibid*, 56-57.

it more difficult for them to attain special knowledge about all different codes.<sup>838</sup> A further criticism is the fact that these firms are instructed by the buyers and are therefore dependent on them as they are their clients.<sup>839</sup> Non-profit NGOs such as the multi-stakeholder initiative Fair Labour Association<sup>840</sup> are seen as more independent than auditing firms, but they, too, are criticised for commonly lacking the capacity to sufficiently monitor the suppliers, especially given the vast number of suppliers which are used by multinational buyers.<sup>841</sup> These deliberations show that, while self-auditing is likely to be limited in its objectivity and in its reach, third party audits do not necessarily provide the buyer with a comprehensive picture either, as they have their limitations, too.

Some of the firms reviewed for this chapter have contractually stipulated a right to conduct audits such as GlaxoSmithKline:

21.4. GSK reserves the right upon reasonable notice...to enter upon Supplier's premises to monitor compliance by the Supplier...<sup>842</sup>

Unilever established a similar right in its terms and conditions:

13. Business Partner Code

...Unilever may from time to time carry out an audit...<sup>843</sup>

These audit clauses provide the Western buyer with a right to conduct an audit when the company wishes to do so.

Although the buyer has the right to audit the supplier, this system faces challenges. First, it is important that, if he uses third party auditors, these are skilled and independent in order to detect breaches of the CSR codes. The strictest CSR policy is essentially ineffective if it is not followed-up by a system of monitoring. The inconsistent manner in which companies currently monitor the CSR policies of their

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<sup>838</sup> *ibid*, 5.

<sup>839</sup> D Wells, 'Too Weak for the Job: Corporate Codes of Conduct, Non-Governmental Organisations and the Regulation of International Labour Standards' (2007) 7 *Global Social Policy* 51, 56-57.

<sup>840</sup> Multi-stakeholder NGOs are non-profit and they have a certain degree of autonomy from the multinational companies. The Fair Labor Association is the most significant multi-stakeholder NGO outside Europe. It is a coalition of NGOs (human rights, labour rights and consumer rights organizations), transnational companies and universities. For more information see: D Wells, 'Too Weak for the Job: Corporate Codes of Conduct, Non-Governmental Organisations and the Regulation of International Labour Standards' (2007) 7 *Global Social Policy* 51, 60.

<sup>841</sup> *ibid*, 63.

<sup>842</sup> GlaxoSmithKline, *Terms and Conditions of Purchase*.

<sup>843</sup> Unilever, *General Terms and Conditions of Purchase of Goods of Unilever Supply Chain Company AG ("Conditions")*.

suppliers has consequently been criticised.<sup>844</sup> Secondly, as the supply chain is a private system between companies, there is also the financial factor that must be taken into account. Monitoring increases the transaction costs and the high number of suppliers used by some companies makes it difficult to put an effective and comprehensive monitoring system in place. Unilever, for example, has 160.000 suppliers.<sup>845</sup> Thirdly, a further difficulty is the lack of monitoring beyond first tier suppliers. As discussed above, supply chains usually go much deeper below the buyers and their first-tier suppliers. However, as sub-suppliers are not encompassed by the contract between buyer and their first-tier supplier, the Western buyer usually only monitors the compliance of his direct supplier. Monitoring further down the supply chain is also difficult to implement, given that the buyers already struggle to monitor the high number of their direct suppliers. All in all, despite the different means of monitoring the compliance of the suppliers, the system remains patchy.

Although the buyer has means to monitor the compliance of its suppliers (and often even a contractual right to carry out monitoring), the monitoring system is somewhat restricted. Among other things, it is difficult for the buyer to monitor a high number of suppliers. The Western companies will therefore not always be aware of breaches of their CSR terms. The enforcement of contracts is limited as a regulatory strategy when the buyer does not know about the lack of compliance with the contract.

#### **4.6 Conclusion**

This chapter has shown that CSR has become an important feature of supply chains in recent years. Reports about violations of the basic human rights of employees at production sites of the suppliers of well-known multinational companies have led to public pressure on Western companies to incorporate CSR policies into their supply chain. Due to reputational concerns, multinational companies have increasingly incorporated CSR codes of conduct into the supply chain contracts with their suppliers using three different mechanisms through which CSR becomes part of the contract: First, terms and conditions incorporated into the buyer's purchase order; secondly, expressly negotiated contracts; and thirdly, inclusion of the CSR policy into the tenderer process. The signing up to the buyer's code of conduct by the supplier does not make the code part of the contractual relations of the two parties, however. The prevalent method in practice is the incorporation of the buyer's terms and conditions, which contain CSR provisions, into the contract.

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<sup>844</sup> D Boyed et al., 'Corporate Social Responsibility in Global Supply Chains: A Procedural Justice Perspective' (2007) 40 *Long Range Planning* 341

<sup>845</sup> Unilever, Unilever Procurement, available at: <http://www.unilever.com/aboutus/supplier/unileverprocurement> (last accessed 27/06/2012).



While the buyer's CSR policy becomes part of the contracts between buyer and supplier and hence creates enforceable contractual terms, it is important to note that contract law faces severe drawbacks in its ability to promote socially responsible behaviour in suppliers in the developing world. First, this situation is particularly due to the doctrine of privity of contract which in general confines the contractual reach of the supply contract to the buyer and their first-tier supplier and does not allow the contract to reach beyond that. The reach of these supply contracts does not expand to sub-suppliers. Secondly, although third parties such as the supplier's employees can acquire a right to enforce contractual duties against the promisor, e.g. the right to join a trade union, due to the Contracts (Rights of Third Parties) Act 1999, this right is regularly excluded by the buyer and supplier. This exclusion significantly limits the ability of contractual law to promote CSR. This situation that the parties can easily exclude liability to third parties reduces the ability of contract law to promote greater socially responsible behaviour of corporations. The intended beneficiaries of the CSR policies are left without a right of action and the enforcement is left to the companies themselves. The purpose of the Contracts (Rights of Third Parties) Act 1999 to promote the position of third parties is therefore effectively contradicted. Thirdly, a further limitation of the use of supply chain contracts for the promotion of CSR is that it is impossible for many suppliers to monitor all of their suppliers and to always be aware of non-compliance in practice. The reason for this difficulty is that many Western buyers use a high number of suppliers and that the supply chain relationship is based on private arrangements with the intention to derive profits. The effective monitoring of compliance would significantly increase the transaction cost of the supply contract. The challenges posed by monitoring are therefore a practical limitation of the ability of supply chain contracts to promote CSR. Fourthly, the use of supply chain contracts as a means to promote CSR and the enforcement of contractual clauses that refer to CSR principles all depend on the Western buyers. It is their decision how they include, monitor and enforce CSR in their supply chain. The fact that the research for this chapter has not shown a single decided case about the breach of CSR terms reveals the economic reality of CSR. It is often just not considered as being important enough for companies to litigate. The promotion of CSR through supply chain contracts between private parties is therefore patchy as the inclusion of CSR into supply contracts as well as the enforcement of CSR terms is a matter of choice for the Western buyer, although reputational risks are an important factor to consider. The limitations of contract law have to be seen in the context of the theoretical framing of contract law, however. It is often said that it is the primary

function of contract law to facilitate exchange.<sup>846</sup> English contract law is said to be embedded in the two principal ideologies of 'market-individualism' and 'consumer-welfarism'.<sup>847</sup> The former of the two ideologies focusses on the holding of contractors to their freely agreed exchanges whereas the latter pursues a fair deal for contractors, in particular consumers.<sup>848</sup> These ideologies of contract law focus on the rights and interests of the contractual parties, but not on the use of contract law to promote the socially responsible conduct of companies for the benefit of the wider public good.

On the other hand, the analysis of the terms and conditions of three multinational companies has shown that the buyer would often be able to procure a remedy for breaches of CSR principles in supply contracts. The contractual terms referring to CSR in the buyer's terms and conditions are classified as innominate terms which allows for flexibility depending on the seriousness of the breach. Among the different CSR principles which are incorporated into supply chain contracts, some are given more prominence than others. Bribery appears to be the strictest, followed by the use of child labour / forced labour. In the middle there are clauses about the conditions at the workplace (e.g. the use of inappropriate language). In contrast, environmental concerns have so far not resulted in binding contractual provisions. It is important to note in this regard that bribery is incidentally subject to the Bribery Act 2010 with its newly created statutory offence for commercial enterprises. It can be argued that severe breaches of the principles prohibiting bribery are repudiatory due to the potential liability that buyers can incur for the conduct of their suppliers. It is therefore argued here that liability in the home states of the buyers can have a positive impact on the promotion of CSR through supply contracts. Breaches of the principles about the use of forced labour and child labour will rather give right to damages. Nevertheless, the fact that buyers can procure a remedy for breaches of CSR principles in supply chain contracts at all demonstrates that, despite its limitations, contract law could promote CSR by making CSR codes of conduct contractually enforceable. This situation challenges the common understanding of codes of conducts as being purely voluntary. Through contract law, CSR obligations can be imposed on suppliers in different countries of the world, particularly in those countries which are known to have a weak legal system or a weak law enforcement mechanism.

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<sup>846</sup> Lord Irvine, 'The Law: An Engine for Trade' (2001) 64 *MLR* 333. Brownsword outlines further objectives of contract law: Its protective function (e.g. the protection of consumers) and, in case of disputes, to put in place machinery for the resolution of such disputes. See: R Brownsword, *Contract Law: Themes for the twenty-first century* (2nd edn, OUP 2006) 39 – 41.

<sup>847</sup> See J Adams and R Brownsword, 'The Ideologies of Contract' (1987) 7 *LS* 207.

<sup>848</sup> R Brownsword, *Contract Law: Themes for the twenty-first century* (2<sup>nd</sup> edn, OUP 2006) 137 – 138.

## Chapter 5: English consumer protection law and Corporate Social Responsibility

### 5.1 The link between consumer protection law and CSR

Consumers are increasingly a driver of CSR activities of companies.<sup>849</sup> Surveys have shown that up to 90% of consumers consider corporate responsibility in their purchase and consumption behaviour.<sup>850</sup> The term 'ethical consumerism' denotes the situation that consumers care about issues of CSR and are positively influenced by a company's CSR engagement in their purchase and consumption behaviours.<sup>851</sup> Consumers' perceptions of companies are better if they believe that companies are committed to CSR.<sup>852</sup> This trend provides an incentive for companies to be socially responsible. Companies have responded to ethical consumerism by giving CSR an increasingly important role in their marketing activities.<sup>853</sup> Brands are portrayed as being socially responsible.<sup>854</sup> Many companies therefore publicise information about their engagement with CSR, including the codes of conduct to which they have signed up.<sup>855</sup> These codes of conduct account for a significant part of the CSR strategy of companies as they usually contain principles of socially responsible behaviour with which companies pledge to comply.<sup>856</sup> A corporate code of conduct is defined as a document which states a number of social and environmental

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<sup>849</sup> See N C Smith, 'Consumers As Drivers Of Corporate Social Responsibility' in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 281.

<sup>850</sup> D Vogel, *The Market for Virtue: The Potential and Limits for Corporate Social Responsibility* (Brookings Institute Press 2006).

<sup>851</sup> It is, however, doubtful to what extent CSR plays a role in the actual purchase decision. Studies suggest that stated ethical intentions rarely translate into actual ethical buying behaviour. See: M Carrington, B Neville and G Whitwell, 'Why Ethical Consumers Don't Walk Their Talk: Towards a Framework for Understanding the Gap Between the Ethical Purchase Intentions and Actual Buying Behaviour of Ethically Minded Consumers' (2010) 97 *Journal of Business Ethics* 139; G Eckhardt, R Belk and T Devinney, 'Why don't consumers consume ethically?' (2010) 9 *Journal of Consumer Behaviour* 426.

<sup>852</sup> N C Smith, 'Consumers As Drivers Of Corporate Social Responsibility' in A Crane, A McWilliams, D Matten et al. (eds), *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 291.

<sup>853</sup> J Leigh and S Waddock, 'The Emergence of Total Responsibility Management Systems: J. Sainsbury's (plc) Voluntary Responsibility Management Systems for Global Food Retail Supply Chains' (2006) 111 (4) *Business and Society Review* 409.

<sup>854</sup> M Polonsky and C Jevons, 'Global branding and strategic CSR: an overview of three types of complexity', (2009) 26 *International Marketing Review* 327, 328.

<sup>855</sup> A study published in 2010 shows that 77 out of the 100 constituent FTSE100 firms had adopted codes of conduct which contain the CSR commitments of the companies. See: L Preuss, 'Codes of Conduct in Organisational Context: From Cascade to Lattice-Work of Codes' (2010) 94 *Journal of Business Ethics* 471, 475: Preuss analysed the range of codes that constituent firms of the FTSE100 index use. His findings show that 77 companies used a general company-wide code of conduct which often also include stipulations for suppliers. For an example of the way companies publicise their CSR policies see: Vodafone, available at:

[http://www.vodafone.com/content/index/uk\\_corporate\\_responsibility.html](http://www.vodafone.com/content/index/uk_corporate_responsibility.html) (last accessed: 20/08/2012).

<sup>856</sup> A Sobczak, 'Are Codes Of Conduct In Global Supply Chains Really Voluntary? From Soft Law Regulation of Labour Relations To Consumer Law' (2006) 16 (2) *Business Ethics Quarterly* 167.

standards and principles that the firm which is a signatory of it is expected to fulfill.<sup>857</sup> Figures show a constant increase of such codes of conduct pertaining to CSR in the past few years.<sup>858</sup> Consumers can view information about the CSR engagement of companies on most corporate websites.<sup>859</sup> These documents often also contain information about the company's adherence to a code of conduct.

It is the purpose of this chapter to analyse to what extent English consumer law promotes socially responsible behaviour in corporations. Upon the basis of this legal analysis, the chapter also seeks to discuss how English consumer law could better encourage greater corporate social responsibility. The structure of the chapter reflects these two purposes. It will first address the question to what extent English consumer law currently promotes CSR. To that end, the chapter will analyse if breaches of CSR policies by companies are encompassed by English consumer law at all and, if this is the case, then examine whether consumers may procure an appropriate remedy in such a situation. Secondly, the chapter will address the question how consumer law could better promote CSR. This section will particularly discuss the recent recommendations of the Law Commission about consumer redress for misleading and aggressive practices which were published in March 2012.<sup>860</sup>

The rise of ethical consumerism raises the question how reliable the information is which companies release about their CSR record and which is targeted, inter alia, at their customers. By publicising information about their CSR policies, companies take advantage of consumer interest in CSR matters.<sup>861</sup> Companies are using CSR as part of their marketing strategy to positively influence their image in the perception of consumers.<sup>862</sup> In return, as there is an indication that consumers are influenced in

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<sup>857</sup> I Mamic, 'Managing global supply chains: the sports footwear, apparel and retail sectors' (2005) 59 *Journal of Business Ethics* 81.

<sup>858</sup> M Anderson and T Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (2009) 14 (2) *Supply Chain Management: An International Journal* 75.

<sup>859</sup> See for example the documentation on the website of British American Tobacco, 'Operating responsibly', available at: [http://www.bat.com/group/sites/uk\\_\\_3mnfen.nsf/vwPagesWebLive/DO52AD7G?opendocument&SKN=1](http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO52AD7G?opendocument&SKN=1) (last accessed: 20/08/2012).

<sup>860</sup> The Law Commission and the Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, March 2012 (Law Com No 332; Scot Law Com No 226), available at: [http://lawcommission.justice.gov.uk/docs/lc332\\_consumer\\_redress.pdf](http://lawcommission.justice.gov.uk/docs/lc332_consumer_redress.pdf) (last accessed: 21/08/2012).

<sup>861</sup> Dawkins reports that UK consumers are critical of business's approach to CSR, with 70 percent agreeing industry and commerce does not pay enough attention to their social responsibilities, but around

75 percent indicate more information about companies' social, ethical, and environmental behaviour would influence what they buy. See: J Dawkins, 'Corporate responsibility: The communication challenge' (2005) 9 *Journal of Communication Management* 108, 115.

<sup>862</sup> Y-S Lii and M Lee, 'Doing Right Leads to Doing Well: When the Type of CSR and Reputation Interact to Affect Consumer Evaluations of the Firm' (2012) 105 *Journal of Business Ethics* 69, 78.

their purchase decisions by the CSR commitment of companies<sup>863</sup>, it is important that the material which companies release about their CSR policies is accurate. Consumers, as the targets of corporate CSR marketing activities, require protection against false information. It is against this background that consumer law could overlap with CSR, as it is the object of consumer law to address the inequality of economic power between consumers and business.<sup>864</sup> Consumer law is not directly linked to CSR, as it is commonly rather associated with issues such as consumers' revocation rights, for example in case of doorstep sales, or with the protection of consumers from the small print in business terms and conditions.<sup>865</sup> However, consumer law and CSR could be linked as consumer law prohibits misleading actions by traders.<sup>866</sup> False information by companies about their CSR practices could constitute such misleading actions. Consumer law could therefore protect consumers in case companies are in breach of their publicly announced CSR commitments, for example, if a company violates the principles of its code of conduct which it has published on its website and to which it pledges to adhere. Consumer law therefore has a potentially important role to play in relation to CSR by protecting consumers against false statements made by companies about their CSR record.

Corporate codes of conduct have often been criticised for being purely voluntary which means that a code could be used by a company to publicly demonstrate its CSR commitment whereas, in reality, the company does not adhere to the principles contained in the code.<sup>867</sup> It is therefore an important question if the publication of the companies' CSR policies, and particularly the corporate codes of conduct, entails any consequences in consumer law if the information is found to be inaccurate.<sup>868</sup> So far, the rise of ethical consumerism and the link between consumers and CSR

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<sup>863</sup> J J Singh, O Iglesias and J M Batista-Foguet, 'Does Having an Ethical Brand Matter? The Influence of Consumer Perceived Ethicality on Trust, Affect and Loyalty' *Journal of Business Ethics*. This article has been accepted for publication in the *Journal of Business Ethics* and is already published online on the journal's website prior to the publication in the journal itself. Date of online publication: 31 January 2012.

<sup>864</sup> G Howells and S Weatherill, *Consumer Protection Law* (2<sup>nd</sup> edn, Ashgate 2005) 6.

<sup>865</sup> See G Woodroffe and L Lowe, *Woodroffe and Lowe's Consumer Law and Practice* (8<sup>th</sup> edn, Sweet & Maxwell 2010) paras 6.24 and 9.01.

<sup>866</sup> Reg 5 (2) or reg 5 (3) Consumer Protection from Unfair Trading Regulations 2008.

<sup>867</sup> See A Sobczak, 'Are Codes of Conduct in Global Supply Chains Really Voluntary? From Soft Law Regulation Of Labour Relations To Consumer Law' (2006) 16 (2) *Business Ethics Quarterly* 167.

<sup>868</sup> See for an introduction into this issue: C Gliński, 'Corporate codes of conduct: moral or legal obligation?' in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 119. The perspective taken on corporate codes of conduct in this chapter of the thesis differs from the previous chapter in that the latter addressed the incorporation of such codes into supply contracts, whereas this chapter analyses their legal effects vis-à-vis consumers.

has been discussed in the management literature.<sup>869</sup> In contrast, there has only been very little writing in the legal literature about the role of consumer law for the promotion of CSR. In fact, there have only been two general overviews in English so far which do not even focus on English consumer law.<sup>870</sup> This chapter seeks to fill this gap due to the potentially important role of consumer law for the protection of consumers against the publication of false information about corporate CSR practices.

It is difficult to define the exact scope of consumer protection. About thirty years ago, in 1979, Lowe and Woodroffe stated in the preface to the first edition of their textbook on consumer protection law, that ‘consumer protection has no precise definition’.<sup>871</sup> One could argue that the situation has become even more difficult since then due to various new legal sources of consumer law which are often EU directives.<sup>872</sup> Consumer law is therefore ‘susceptible to neither neat nor narrow definition’.<sup>873</sup> Notably, it encompasses both public law and private law.<sup>874</sup> Its scope is open-ended.<sup>875</sup> Generally speaking, consumer protection is ‘the protection, especially by legal means, of consumers’.<sup>876</sup> The Consumer Protection from Unfair Trading Regulations 2008 which are analysed in this chapter define a consumer as ‘any individual who in relation to a commercial practice is acting for purposes which are outside his business’.<sup>877</sup> Due to the overall focus of the thesis on private law, this chapter seeks to analyse how the private law aspects of consumer protection law,

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<sup>869</sup> See for example C Valor, ‘Can Consumers Buy Responsibly? Analysis and Solutions for Market Failures’ (2008) 31 *Journal of Consumer Policy* 315; J Singh, O Iglesias and J Batista-Foguet, ‘Does Having an Ethical Brand Matter? The Influence of Consumer Perceived Ethicality on Trust, Affect and Loyalty’ *Journal of Business Ethics*, published online: 31 January 2012; G Eckhardt, R Belk and T Devinney, ‘Why don’t consumers consume ethically?’ (2010) 9 *Journal of Consumer Behaviour* 426; M Carrington, B Neville and G Whitwell, ‘Why Ethical Consumers Don’t Walk Their Talk: Towards a Framework for Understanding the Gap Between the Ethical Purchase Intentions and Actual Buying Behaviour of Ethically Minded Consumers’ (2010) 97 *Journal of Business Ethics* 139.

<sup>870</sup> See C Gliniski, ‘Corporate codes of conduct: moral or legal obligation?’ in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 119; A Sobczak, ‘Are Codes of Conduct in Global Supply Chains Really Voluntary? From Soft Law Regulation Of Labour Relations To Consumer Law’ (2006) 16 (2) *Business Ethics Quarterly* 167.

<sup>871</sup> R Lowe and G Woodroffe in the preface to the first edition of their book on consumer law, see G Woodroffe and L Lowe, *Woodroffe and Lowe’s Consumer Law and Practice* (8<sup>th</sup> edn, Sweet & Maxwell 2010) Preface.

<sup>872</sup> For instance the EU Unfair Commercial Practices Directive 2005, Directive 2005/29/EC.

<sup>873</sup> G Howells and S Weatherill, *Consumer Protection Law* (2<sup>nd</sup> edn, Ashgate 2005) 5.

<sup>874</sup> *ibid.*

<sup>875</sup> *ibid.*

<sup>876</sup> J Law (ed), *Oxford Dictionary of Law* (7<sup>th</sup> edn, OUP 2009).

<sup>877</sup> The long-standing definition used for consumers in English law differs from the European approach which is followed by the CPRs. The English approach, used in the Unfair Contract Terms Act 1977, refers to a person who ‘deals as consumer’. The definition used in European directives is more restrictive, as it only covers individuals who are acting for purposes outside their business. The CPRs contain the definition referred to above in reg 2 (1). It is based on the European approach. See for an overview of the topic: The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading and Aggressive Practices* (Law Com No 332 / Scot Law Com No 226, March 2012) 57 – 58.

i.e. the legal rules which govern the relationship between consumers and business in private law, promote or could promote CSR. In terms of jurisdictional scope, the chapter addresses those situations where English law is applicable.

## **5.2 Jurisdictional scope of the chapter**

This chapter will first establish when English courts have jurisdiction to hear the merits of the dispute and when English law is applicable. The consumer law issues addressed in this chapter are closely related to the sale of goods. Therefore, the private international law rules discussed for the previous chapter on supply contracts are relevant to some extent here, too.

When an action based on consumer law is brought against an English company in English courts, the courts must apply the Brussels I Regulation in order to determine whether they can assume jurisdiction.<sup>878</sup> Pursuant to Article 2 (1) of the Regulation, persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State. English companies can therefore be sued in English courts by consumers for an alleged breach of consumer law.

The question if English consumer law is applicable is governed by the Rome I Regulation.<sup>879</sup> This Regulation governs the choice of law in the European Union pertaining to contractual obligations. The Regulation stipulates which law is to be used to interpret contracts with a foreign element. Article 6 (1) of the Regulation stipulates that consumer contracts shall be governed by the law of the country where the consumer has his habitual residence, provided that the entrepreneur pursues his commercial or professional activities in this country, too, or if the entrepreneur by any means, directs such activities to that country or to several countries including that country, and the contract falls within the scope of such activities. The parties may also choose the law applicable to a contract which fulfills the requirements of Article 6 (2) as long as the law chosen does not deprive the consumer of the protection offered to him by the law which would otherwise govern the contract pursuant to Article 6 (1). In case the conditions of Article 6 (1) are not satisfied, the law governing the contract is determined by Articles 3 and 4 of the Regulation. Pursuant to Article 3 of the Regulation, the contract shall be governed by the law chosen by the parties. Article 4 establishes rules for the determination of the applicable law in specific circumstances where the parties have not chosen a

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<sup>878</sup> Council Regulation (EC) No 44/2001 of 22<sup>nd</sup> December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

<sup>879</sup> Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

law. Notably, (a) stipulates that a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence. These rules mean that, in practice, consumer disputes involving violations of CSR by a company are governed by the following laws: First, where both the consumer and the trader have their habitual residence in England or Wales, the contract is subject to English law. Secondly, where the trader has his habitual residence in England or Wales, but the consumer habitually resides abroad, then the law of the country where the consumer has his/her habitual residence is applicable pursuant to Article 6 (1) if the trader pursues his commercial activities in that country, too, or directs his commercial activities to that country.

### **5.3 Does English consumer law promote the socially responsible behaviour of companies?**

The following part analyses if English consumer law promotes CSR. It focusses on the Consumer Protection from Unfair Trading Regulations 2008 and the law of misrepresentation.

#### **5.3.1 Consumer Protection from Unfair Trading Regulations 2008**

##### **5.3.1.1 The scope of the Regulations**

Breaches of CSR could be covered by the Consumer Protection from Unfair Trading Regulations 2008 (hereafter: CPRs) which implement the EU Unfair Commercial Practices Directive 2005.<sup>880</sup> The CPRs primarily address business-to-consumer transactions.<sup>881</sup> They apply to conduct made before, during and after the contract is made.

As this thesis focusses on private law, it is important to note that the recent report by the Law Commission on the introduction of a private remedy in English consumer law classifies the CPRs as public law as they only provide for public enforcement; and the law of misrepresentation as the private law on misleading and aggressive trading practices. However, both the CPRs and the law of misrepresentation will be analysed in this chapter with regard to the promotion of CSR through consumer law. There are two reasons for this approach despite the classification of the CPRs as public law: First, the CPRs and the law of misrepresentation (which is often also

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<sup>880</sup> Directive 2005/29/EC.

<sup>881</sup> This sentence refers to 'primarily', as most commercial practices will occur where a trader deals directly with consumers. However, any commercial practice that has the potential to affect consumers can be encompassed by the CPRs. For example where a trader sells a product to a consumer, acts or omissions which occur further up the supply chain may also constitute commercial practices. See: OFT, *Guidance on the Consumer Protection from Unfair Trading Regulations 2008*, para 4.4., available at: [http://www.of.gov.uk/shared\\_of/business\\_leaflets/cpregs/oft1008.pdf](http://www.of.gov.uk/shared_of/business_leaflets/cpregs/oft1008.pdf) (last accessed: 19/03/2013)



called the 'pre-existing private law' in respect of consumer protection) extensively overlap. Both areas address the protection of consumers from unfair commercial actions by business. It would be difficult to understand the effects of one source without analysing the other. Secondly, and closely related to this point, is that there is an ongoing debate about the introduction of a private remedy in English consumer law which would provide consumers with a private right of action where they have suffered from an unfair commercial practice under the CPRs.<sup>882</sup> Following the report by the Law Commission, issued in March 2012, the government now engages with the question of whether or not a private remedy for consumers should be introduced. The Law Commission recommends the introduction of a private remedy for consumers in a separate Act based on the CPRs to provide redress in private law to consumers who experience misleading and aggressive practices.<sup>883</sup> The recommendation would leave the Regulations within the realm of public law as they would continue to be subject to public enforcement only. Even if such a private remedy is not introduced within the CPRs (as suggested, for example, by Consumer Focus), but separately, the new Act would still closely overlap with the CPRs. The fact that the new Act would build on and overlap with the CPRs necessitates a legal analysis of the CPRs, even in a thesis which focusses on private law, in order to understand the recommendations. In fact, the suggested unfair commercial practices in the new Act would mirror the CPRs. The discussion of the Law Commission's proposals will therefore refer to the analysis of the CPRs in this section.

### **5.3.1.2 Are breaches of CSR commitments by companies covered?**

The CPRs prohibit the use of 'unfair commercial practices' pursuant to reg 3 (1) CPRs. A 'commercial practice' is defined in reg 2 (1) CPRs as 'any act, omission, course of conduct, representation or commercial communication (including advertising or marketing) by a trader which is directly connected with the promotion, sale or supply of a product to or from consumers, whether occurring before, during or after a commercial transaction (if any) in relation to the product'. A category of

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<sup>882</sup> The statutory consumer organisation Consumer Focus (which was replaced in May 2013 by Consumer Futures) suggests the introduction of private redress for consumers in private law for misleading and aggressive practices by business within the CPRs, see Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009) 6, available at: <http://www.consumerfocus.org.uk/files/2010/12/Waiting-to-be-heard.pdf> (last accessed: 23/08/2012). The Law Commission, on the other hand, recommends the introduction of private redress for consumers in a separate Act based on the CPRs, see The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading and Aggressive Practices* (Law Com No 332 / Scot Law Com No 226, March 2012) 52.

<sup>883</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading and Aggressive Practices* (Law Com No 332 / Scot Law Com No 226, March 2012) 52.

unfair commercial practices is misleading actions.<sup>884</sup> Pursuant to reg 5 (3) (b) CPRs a commercial practice is a misleading action if it concerns the failure by a trader to comply with a commitment contained in a code of conduct with which the trader has undertaken to comply. Reg 2 (1) of the CPRs defines 'code of conduct' in the following way: 'an agreement or set of rules (which is not imposed by legal or administrative requirements), which defines the behaviour of traders who undertake to be bound by it in relation to one or more commercial practices or business sectors.'

In this situation, the following conditions must be satisfied: First, the trader must indicate in a commercial practice that he is bound by that code of conduct. Secondly, it is required that the commitment is firm and capable of being verified and not aspirational. Moreover, the commitment must cause or be likely to cause the average consumer to take a transactional decision he would not have taken otherwise, taking account of its factual context and of all its features and circumstances.

#### **5.3.1.2.1 Case study: Do breaches of the ETI Base Code constitute misleading actions?**

Against this background, it will now be analysed if a breach of the Ethical Trading Initiative (ETI) Base Code could constitute a misleading action pursuant to reg 5 (3) (b) of the CPRs if it were shown that a company that has adopted this code has not followed one or more of its clauses. The ETI is an organisation whose members are companies, trade unions and voluntary organisations.<sup>885</sup> It promotes ethical trading and its aim is to improve working conditions in the supply chains of companies.<sup>886</sup> Companies that join the ETI must adopt the ETI Base Code in full.<sup>887</sup> The ETI Base Code is based on the Conventions of the International Labour Organisation (ILO).<sup>888</sup> The ETI's members (that have consequently signed up to the ETI Base Code) comprise a range of large English companies in the retail and garment industry such as Tesco, Next, River Island, J Sainsbury and Marks & Spencer.<sup>889</sup> The ETI Base Code was chosen for the case study in this chapter, as it is an important code of conduct in terms of the CSR commitments of English companies due to its

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<sup>884</sup> Reg 5 CPRs.

<sup>885</sup> <http://www.ethicaltrade.org/about-eti> (last accessed: 19/03/2013).

<sup>886</sup> See the statement on ETI's website: "Our vision is a world where all workers are free from exploitation and discrimination, and work in conditions of freedom, security and equity.", see: <http://www.ethicaltrade.org/about-eti> (last accessed: 19/03/2013).

<sup>887</sup> <http://www.ethicaltrade.org/about-eti/what-companies-sign-up-to> (last accessed: 19/03/2013).

<sup>888</sup> *ibid.*

<sup>889</sup> For a list of members see: <http://www.ethicaltrade.org/about-eti/our-members> (last accessed: 19/03/2013).

membership which consists of firms which account for a significant part of the retail of food and clothes in England. Many consumers will purchase goods from one or more of these companies on a regular basis. Consumers are therefore commonly exposed to advertisement of these companies. The companies usually outline their CSR commitments in a specific section on their website.<sup>890</sup> The ETI Base Code is therefore a suitable case study for this chapter which analyses to what extent English consumer law protects consumers against misleading information by companies about their CSR records.

The following clauses are examples of the ETI Base Code:

**1. Employment is freely chosen**

1.1. There is no forced, bonded or involuntary prison labour.

**2. Freedom of association and the right to collective bargaining are respected**

2.1. Workers, without distinction, have the right to join or form trade unions of their own choosing and to bargain collectively.

2.2. The employer adopts an open attitude towards the activities of trade unions and their organisational activities.

**4. Child labour shall not be used**

4.1. There shall be no new recruitment of child labour.

**6. Working hours are not excessive**

6.2. In any event, workers shall not on a regular basis be required to work in excess of 48 hours per week and shall be provided with at least one day off for every 7 day period on average. Overtime shall be voluntary, shall not exceed 12 hours per week, shall not be demanded on a regular basis and shall always be compensated at a premium rate.

**5.3.1.2.2 Indication in a commercial practice that the company is bound by its code of conduct**

The first condition of reg 5 (3) (b) CPRs is that a company must indicate in a commercial practice that it is bound by this code. This condition consists of two elements: First, there must be a code of conduct in terms of regs 5 (3) (b), 2 (1) CPRs. Secondly, a company must have indicated in a commercial practice that it is bound by this code.

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<sup>890</sup> See for example the reference to the ETI by Tesco (<http://www.tescopl.com/site/library/policiesandfactsheets/ethical-trading-at-tesco.htm>) or Sainsbury (<http://www.j-sainsbury.co.uk/suppliers/ethical-trading/>) or Next plc (<http://www.nextplc.co.uk/corporate-responsibility/code-of-practice.aspx>), (last accessed: 19/03/2013).

If this route of promoting CSR is to be successful, the ETI Base Code must first be a code of conduct pursuant to regs 5 (3) (b), 2 (1) CPRs. In reg 2 (1) CPRs a code of conduct is defined in the following way:

“Code of conduct” means an agreement or set of rules (which is not imposed by legal or administrative requirements), which defines the behaviour of traders who undertake to be bound by it in relation to one or more commercial practices.

This definition requires that it is necessary that there is an agreement or a set of rules which are not imposed by law, regulation or administrative provision. With its clauses pertaining to the working condition, the ETI Base Code contains a set of rules. These rules were developed by the ETI without involvement of the state. The companies that adopt this code must undertake to be bound by it. What is not included in this definition is a clarification of the question of what kinds of codes of conduct are encompassed by this definition, i.e. corporate codes of conduct (codes of conducts that companies have produced themselves, e.g. Unilever, Code of Business Conduct) or codes of conduct developed by third parties. The guidance on the CPRs, published by the OFT, does not provide further assistance with the question.<sup>891</sup> The same applies to the guidance issued by the European Commission on the Unfair Commercial Practices Directive, which underlies the CPRs.<sup>892</sup> Moreover, this issue has not yet been decided by a court.

As the guidance does not discuss this issue, one could assume that the CPRs encompass both types of code of conduct. However, on a literal reading of the definition in reg 2 (1) CPRs, it is important to note the following clause: ‘which defines the behaviour of traders...’. The definition therefore refers to codes of conduct that are adopted by traders rather than just one trader which is, most of the time, the case if a company develops and adopts its own code of conduct. Moreover, the example of a breach of a commitment made in a code of conduct used by the OFT in its guidance on the CPRs (which is subsequently also used as an example by the Commission in its guidance on the Unfair Commercial Practices Directive which were published later than the document from the OFT) refers to a trader who has agreed to be bound by a code of practice that promotes the sustainable use of woods and which requires its members not to use hardwood from unsustainable sources. This example also refers to members of the code in the plural. It is therefore assumed here that, in any case, the CPRs encompass third

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<sup>891</sup> See OFT, Guidance on the Consumer Protection from Unfair Trading Regulations 2008, available at: [http://www.offt.gov.uk/shared\\_offt/business\\_leaflets/cpregs/oft1008.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/cpregs/oft1008.pdf) (last accessed: 19/03/2013).

<sup>892</sup> European Commission, Commission staff working document Guidance on the implementation/application of directive 2005/29/EC on unfair commercial practices, SEC (2009) 1666, available at: [http://ec.europa.eu/consumers/rights/index\\_en.htm](http://ec.europa.eu/consumers/rights/index_en.htm) (last accessed: 19/03/2013).

party codes of conduct that are adopted by more than just one company. The ETI Base Code is such a code, as the ETI is an organisation which has several members. The ETI has developed the Base Code that its members must adopt. However, it could also be argued that the interpretation of 'code of conduct' is wider and also encompasses the codes developed by one company only, as the definition of 'code owner' only refers to 'a trader or a body responsible for...'. It is therefore also possible that a code which is developed by one company satisfies the condition of reg 2 (1) CPRs, as this code of conduct could later on be adopted by other companies, too, hence ensuring that it defines the behaviour of 'traders'. Howells therefore emphasises that the definition makes clear that 'even a trader or group of traders may qualify' as code owner.<sup>893</sup>

Whilst an interpretation that also includes corporate codes of conduct is possible, this chapter uses the ETI Base Code as a third party code in accordance with reg 2 (1) CPRs. Moreover, as already noted, this code is also of a significant relevance in commercial practice due to the number of large companies that have adopted it.

Secondly, it is necessary that a company must have indicated in a commercial practice that it is bound by this code.

Pursuant to reg 2 (1) CPRs, commercial practice means

any act, omission, course of conduct, representation or commercial communication (including advertising and marketing) by a trader, which is directly connected with the promotion, sale or supply of a product to or from consumers, whether occurring before, during or after a commercial transaction (if any) in relation to a product.

It is therefore necessary that the company has declared that it is bound to the ETI Base Code in direct connection with the promotion or sale of a product to consumers. The example used in the OFT Guidance refers to labels and logos used by companies on the product.<sup>894</sup> This condition might limit the actual scope of reg 5 (3) CPRs, as it could be interpreted in a way that the CSR commitments of a company are not automatically directly linked to the promotion or sale of a product unless the company uses its CSR policies in its marketing policies. Although membership of the ETI Base Code is not placed upon products by way of a logo or label, it is argued here that information on a company's website about its CSR commitments which is close to the online shopping facilities is closely linked to the promotion and the sale of products. This situation applies to the website of the

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<sup>893</sup> G Howells, Codes of conduct, in: G Howells, H W Micklitz and T Wilhelmsson (eds), *European Fair Trading Law: The unfair commercial practices directive* (Ashgate Publishing Limited 2006) 206.

<sup>894</sup> See OFT, Guidance on the Consumer Protection from Unfair Trading Regulations 2008, paras 4.4. and 7.11, available at: [http://www.of.gov.uk/shared\\_of/business\\_leaflets/cpregs/oft1008.pdf](http://www.of.gov.uk/shared_of/business_leaflets/cpregs/oft1008.pdf) (last accessed: 19/03/2013).

fashion retailer River Island in terms of its ETI membership. Upon River Island's website, there is a section on Corporate Social Responsibility and the Ethical Trading Initiative which is very close to the online shop and therefore directly linked to the promotion of its goods. In the sections on CSR and the ETI, the company outlines its commitment to CSR and to 'safeguarding and improving the rights and working conditions of workers in those factories which supply our products'.<sup>895</sup> The information provided on the ETI is linked to the promotion and sale of products, as the website is used both to promote and to sell the clothes currently offered by River Island. As online shoppers do not need to undertake a lengthy search for CSR and ETI, it is argued here that this situation satisfies the condition of being 'directly connected with the promotion, sale or supply of a product to or from consumers'.

For example, River Island publishes the following statement on its website intended for public relations:

Code of Practice: River Island is firmly committed to the adoption and integration of the ETI Base Code into our World Wide Ethical Policy, throughout our global supply chain and into our core business activities. We feel that by working with the ETI and its other members we will be able to draw on the wider pool of experience which exists in the collective organisation.<sup>896</sup>

This statement can be understood as a declaration that River Island is bound by the ETI Base Code. The company has indicated its binding to the code in a commercial practice connected with the promotion of a product to consumers pursuant to reg 2 (1) CPRs.

### **5.3.1.2.3 The commitment must be firm and verifiable and not aspirational**

The second condition of reg 5 (3) (b) CPRs is that the commitment is firm and verifiable and not aspirational. In this respect, it is necessary to distinguish between the different exemplary clauses of the ETI Base Code referred to above. The clauses pertaining to the prohibition of forced labour<sup>897</sup> and the right to join or to form trade unions of their own choosing and to bargain collectively<sup>898</sup> are firm and verifiable. The same applies to the clause that no new child labour will be recruited.<sup>899</sup>

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<sup>895</sup> River Island, Ethical Trading Initiative, available at: <http://www.riverisland.com/inside-river-island/about-us/ethical-trading-initiatives> (last accessed: 19/03/2013).

<sup>896</sup> See River Island, Ethical Trading Initiative, available at: <http://www.riverisland.com/inside-river-island/about-us/ethical-trading-initiatives> (last accessed: 19/03/2013).

<sup>897</sup> Clause 1.1 ETI Base Code.

<sup>898</sup> Clause 2.1 ETI Base Code.

<sup>899</sup> Clause 4.1 ETI Base Code. Child is defined in the appendices of the ETI Base Code as 'any person less than 15 years of age'. However, where the local minimum age law is set at 14 years of age in accordance with developing country exceptions under ILO Convention No. 138, the lower will apply. With regards to existing child labour, there is a clause in the ETI Base Code that requires companies to

Slightly less firm than these clauses is the provision that workers shall not be required to work in excess of 48 hours per week due to the limitation 'on a regular basis'.<sup>900</sup> This limitation means that it is possible that workers will be required to work overtime as long as it keeps within the obligation that overtime shall not exceed 12 hours. Finally, in comparison to these clauses, the obligation on companies to 'adopt an open attitude towards the activities of trade unions and their organisational activities' is rather vague.<sup>901</sup> Whilst employees are allowed to join or to form a trade union, there might still be significant varieties in the ways in which companies undertake their 'open attitude towards the activities of trade unions'. It is not prescribed to what extent they actually respect the right of their employees to bargain collectively. It is still possible that companies formally allow their employees to be members of trade unions, whilst they practically exercise influence on them not to negotiate for significant improvements of working conditions or pay increases. A company that has adopted the ETI Base Code could therefore still claim to comply with the clauses of the code, even if it restricts the collective bargaining of its employees. This clause is therefore not firm. Hence, breaches of the clause pertaining to the actual enjoyment of the right to collective bargaining are difficult to verify. It is therefore unlikely that a company that has adopted the ETI Base Code will commit an unfair constitutional practice in accordance with the CPRs for a breach of this clause.

#### **5.3.1.2.4 The commitment must cause or be likely to cause the average consumer to take a transactional decision**

The final condition of reg 5 (3) (b) CPRs is that commitments in Unilever's code of conduct which satisfy the first two conditions must also cause or be likely to cause the average consumer to take a transactional decision he would otherwise not have taken. The two abstract terms which require interpretation are 'average consumer' and 'transactional decision'. The High Court has recently construed these concepts in *Office of Fair Trading v Purely Creative Ltd.*<sup>902</sup> In this case, the Office of Fair Trading applied for an enforcement order in relation to the CPRs. The High Court held that 'it was common ground' that any decision with an 'economic consequence'

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provide for the transition of any child found to be performing child labour to enable him or her to attend to remain in quality education until no longer a child.

<sup>900</sup> Clause 6.2. ETI Base Code.

<sup>901</sup> An even clearer example of a purely aspirational clause is following commitment in Unilever's code of conduct: 'The environment: Unilever is committed to making continuous improvements in the management of our environmental impact and to the longer-term goal of developing a sustainable business.', Unilever, *Code of Business Principles*, available at: <http://www.unilever.com/aboutus/purposeandprinciples/ourprinciples/> (last accessed: 17/03/2013).

<sup>902</sup> *Office of Fair Trading v Purely Creative Ltd* [2011] EWHC 106 (Ch). The ECJ has now decided in the reference for a preliminary ruling in this case by the Court of Appeal (England and Wales), see: *Purely Creative Ltd and Others v Office of Fair Trading* (Case C-428/11), [2013] 1 C.M.L.R. 35.

was a transactional decision. This broad interpretation is based on reg 2 (1) CPRs which stipulates that a transactional decision means any decision taken by a consumer, whether it is to act or to refrain from acting concerning, inter alia, whether, how and on what terms to purchase. Consequently, the term encompasses any purchase decision of a consumer which is based on the seller's CSR record.

With regard to the concept of an 'average consumer', reg 2 (1) CPRs stipulates that this term shall be construed in accordance with paragraphs (2) to (6) of reg 2 CPRs. Pursuant to s2 (2) CPRs, in determining the effect of a commercial practice on the average consumer, account shall be taken of the material characteristics of such an average consumer including his being reasonably well-informed, reasonably observant and circumspect.<sup>903</sup> The paragraphs (3) to (6) are of little use in the context here, however, as they only further specify the concept of the average consumer in relation to particular groups of consumers. The decision of the High Court, inter alia, concerned the question how an average consumer would understand the mailing of promotions to consumers which suggests that they had won a prize when they had not or would have had to pay to receive the prize.<sup>904</sup> In this respect, the court held that there is a proposition that the CPRs would protect consumers who take reasonable care of themselves rather than ignorant, careless or over-hasty consumers.<sup>905</sup> Notably, it would not necessarily follow from this standard that the average consumer would read the entirety of a promotion.<sup>906</sup> The High Court's approach is said to follow the interpretation adopted by the European Commission.<sup>907</sup> In its guidance on the Unfair Commercial Practices Directive (which underlies the CPRs), the Commission interprets the 'average consumer' as a critical person who is conscious and circumspect in his or her market behaviour.<sup>908</sup> He or she should inform themselves about the quality and price of products and make efficient choices. In its preliminary ruling in this case, the ECJ emphasised that it is

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<sup>903</sup> The concept of the average consumer was developed by the European Court of Justice. The ECJ, when weighing the risk of misleading consumers against the requirements of the free movement of goods, has held that, '...in order to determine whether a particular description, trade mark or promotional description or statement is misleading, it is necessary to take into account the presumed expectations of an average consumer who is reasonably well informed and reasonably observant and circumspect.' See Case C-210/96 *Gut Springenheide GmbH, Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung and Another* [1998] ECR I-4657, para 31.

<sup>904</sup> *ibid.*

<sup>905</sup> Similarly, the Law Commission states that the 'average consumer' test would be based on a consumer who is critical and rational, see The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading and Aggressive Practices*, Law Com No 332 / Scot Law Com No 226, March 2012, para 2.32.

<sup>906</sup> *ibid.*

<sup>907</sup> O Bray and M Starmer, 'Office of Fair Trading v Purely Creative Ltd: the net tightens on exponents of sharp commercial practices' (2011) 22 *Entertainment Law Review* 118, 121.

<sup>908</sup> European Commission, 'Guidance on the implementation and application of Directive 2005/29/EC on unfair commercial practices' SEC (2009) 1666, available at: [http://ec.europa.eu/consumers/rights/docs/Guidance\\_UCP\\_Directive\\_en.pdf](http://ec.europa.eu/consumers/rights/docs/Guidance_UCP_Directive_en.pdf) (last accessed: 11/09/2012).



for the national courts to establish the typical reaction of the average consumer in a case.<sup>909</sup> So, in summary, the average consumer is one who is informed, observant and able to take care of himself.

Linking the concept back to the final condition of reg 5 (3) (b), the key issue here is if firm and verifiable commitments in the ETI Base Code would cause or are likely to cause the average consumer to purchase or refrain from purchasing goods from Unilever. Studies have shown that up to 90% of consumers consider CSR in their purchase and consumption behaviour<sup>910</sup>, although it is doubtful to what extent this consideration has an impact on the actual purchase decision of consumers.<sup>911</sup> However, the issue raised by reg 5 (3) (b) CPRs is not to what extent consumers generally make their purchase decision on the basis of the CSR engagement of companies. Rather the issue here is if the breach of a CSR commitment in a code of conduct which the company has publicly declared to adhere to has an effect on the purchase decision of the average consumer. One can assume that a well-informed, observant and circumspect consumer would expect a company to comply with the CSR commitments that it publicly promises. Such a consumer would be likely to make purchase decisions on the basis of this expectation, e.g. if the average consumer reads that a company in the garment industry does not employ child labour then an informed and observant consumer would expect the company to comply with this commitment.

Further information about the question whether the breach of a code of conduct 'causes or is likely to cause the average consumer to take a transactional decision he would not have taken otherwise' can be found in the guidance on the CPRs, published by the Office of Fair Trading which is the responsible body for the enforcement of the regulations.<sup>912</sup> The guidance provides an example of the breach of a corporate code of conduct which would constitute a breach of reg 5 (3) (b) CPRs. This example is significant from a CSR point of view. It outlines the scenario of a trader who has agreed to be bound by a code of practice which promotes the

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<sup>909</sup> *Purely Creative Ltd and Others v Office of Fair Trading* (Case C-428/11), [2013] 1 C.M.L.R. 35.

<sup>910</sup> D Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institute Press 2006).

<sup>911</sup> G Eckhardt, R Belk and T Devinney, 'Why don't consumers consume ethically?' (2010) 9 *Journal of Consumer Behaviour* 426; M Carrington, B Neville and G Whitwell, 'Why Ethical Consumers Don't Walk Their Talk: Towards a Framework for Understanding the Gap Between the Ethical Purchase Intentions and Actual Buying Behaviour of Ethically Minded Consumers' (2010) 97 *Journal of Business Ethics* 139.

<sup>912</sup> Under the Enterprise Act 2002, the enforcement body of the Consumer Protection from Unfair Trading Regulations is the OFT as well as trading standards. For the OFT guidance see: OFT, *Guidance on Consumer Protection from Unfair Trading Regulations* (May 2008), available at: [http://www.offt.gov.uk/shared\\_offt/business\\_leaflets/cpregs/oft1008.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/cpregs/oft1008.pdf) (last accessed: 23/08/2012). The Office of Fair Trading is the responsible body for the enforcement of the CPRs, as there trading standards services.

sustainable use of wood. The trader consequently displays the logo of this code in advertising campaigns.<sup>913</sup> If this code contains a commitment by signatories of the code that they will not use hardwood from unsustainable sources, but the trader in the example here, in fact, uses hardwood from endangered rainforests he would not comply with the code. Consequently, he would breach reg 5 (3) (b) CPRs as the commitment he has failed to comply with is a firm and verifiable breach. Moreover, the average consumer could expect members of the code to sell products which comply with the code and is deemed likely to make a purchase decision on the basis of this expectation. The breach of the code of conduct would therefore amount to a misleading action which, in turn, constitutes an unfair commercial practice. If one applies this approach in the OFT's guidance to the clause of the ETI Base Code used in this section, then consumers would expect a company that has adopted the ETI Base Code to comply with the firm and verifiable commitments referring to forced labour and child labour as well as the joining of trade unions. Consumers would be likely to be deemed to have made purchase decisions on the basis of this expectation. Consequently, the condition in reg 5 (3) (b) CPRs that the breach must have caused or be likely to cause a transactional decision of an average consumer would be satisfied if a company such as River Island that has adopted the ETI Base Code were found to be in breach with these commitments.

This analysis shows that breaches of firm and verifiable commitments in the ETI Base Code are likely to constitute an unfair commercial practice under the CPRs as long as the company indicates its membership of the ETI in a way that is directly linked and connected with the promotion, sale or supply of a product. Unfair commercial practices are prohibited by reg 3 (1) CPRs. Consumer law, through the CPRs, therefore encompasses breaches of CSR commitments in corporate codes of conduct.

### **5.3.1.3 Do consumers procure an appropriate remedy for unlawful commercial practices?**

However, these regulations only promote CSR in a meaningful way if the consumers procure an appropriate remedy where a company is found to have committed an unlawful commercial practice by breaching a CSR commitment in its code of conduct.

The CPRs make certain unfair commercial practices a criminal offence (see reg 8 and reg 9 CPRs). These entail a penalty (reg 13 CPRs). However, as this chapter

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<sup>913</sup> *ibid*, p 33.

focuses on private law this legal consequence is beyond the scope of the analysis here. It is nevertheless important to note that breaches of corporate codes of conduct pursuant to reg 5 (3) (b) CPRs<sup>914</sup> do not constitute offences pursuant to reg 9 CPRs. On the contrary, all other misleading actions in reg 5 CPRs are encompassed by the scope of reg 9 CPRs. The CPRs therefore give breaches of corporate codes of conduct a lower level of protection than other unfair commercial practices.<sup>915</sup> Breaches of corporate codes of conduct pursuant to reg 5 (3) (b) CPRs can, however, be enforced through injunctive civil actions.<sup>916</sup> The responsible bodies for the enforcement of the regulations are the Office of Fair Trading (OFT)<sup>917</sup> as well as every local weights and measures authority in Great Britain (Trading Standards Services).<sup>918</sup> Notably, consumers are not given the right to enforce the CPRs. This enforcement regime is subject to Part 8 of the Enterprise Act 2002.<sup>919</sup> The enforcers can bring proceedings for an enforcement order where a business has engaged in conduct that constitutes either a domestic or a European Union infringement or is likely to engage in conduct that constitutes a European Union infringement.<sup>920</sup> The

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<sup>914</sup> The failure to comply with a commitment contained in a code of conduct which the trader has undertaken to comply with is a misleading action if the conditions set out in reg 5 (3) (b) CPRs are met.

<sup>915</sup> This situation is a severe limitation of the CPRs ability to address breaches of codes of conduct, as strict liability would mean that every breach of a code of conduct which satisfies the conditions of reg 5 (3) (b) would automatically be an offence. Alternatively, reg 8 makes it an offence if a trader knowingly or recklessly engages in a commercial practice which contravenes the requirements of professional diligence under regulation 3 (3) (a) and the practice materially distorts or is likely to materially distort the economic behaviour of the average consumer with regard to the product under regulation 3 (3) (b). Reg 3 (3) (a) is the general prohibition of unfair practices and is rather a 'catch-all' provision in contrast to the specific types of unfair commercial practices in the subsequent provisions such as the misleading action in reg 5 (3) (b). Even if, due to the general nature of the provision, the breach of a corporate code of conduct by a company is likely to contravene the requirement of professional diligence to distort the economic behaviour of the average consumer to the product, this does still not mean that the breach constitutes an offence pursuant to reg 8. The reason is that the contravention mentioned in reg 3 (3) (a) must be 'knowingly or recklessly'. This additional requirement of 'knowingly or recklessly' imposes a further hurdle for the ability of the CPR to follow-up breaches of corporate code of conduct. This standard of proof is more difficult to meet than the failure to comply with a commitment contained in code of conduct pursuant to reg 5 (3) (b) which would be sufficient to constitute an offence if there was not the exclusion in reg 9. In case this requirement is nevertheless met (and the company is guilty of an offence pursuant to reg 8), the company is subject to the penalties established in regs 13 to 18. Offences by a body corporate are addressed in reg 15.

<sup>916</sup> See OFT, *Guidance on Consumer Protection from Unfair Trading Regulations* (May 2008), para 11.15.

<sup>917</sup> The Office of Fair Trading (OFT) is the UK's consumer and competition authority. It is a non-ministerial government department which was established by statute in 1973. For more information see: <http://www.offt.gov.uk/> (last accessed: 09/08/2012). The government will merge most of the Office of Fair Trading and the Competition Commission into a new single organisation, the Competition and Markets Authority, which is due to begin operation on 1 April 2014, see: Speech by Alex Chisholm, CEO-designate of the Competition and Markets Authority, 'The New Competition and Markets Authority: Aspirations and Challenges', delivered on 24 April 2013, available at: <https://www.gov.uk/government/speeches/the-new-competition-and-markets-authority-aspirations-and-challenges> (last accessed: 11/06/2013).

<sup>918</sup> Reg 2 (1) CPRs.

<sup>919</sup> Reg 26 of the CPRs makes Part 8 of the Enterprise Act 2002 applicable. Part 8 of the Enterprise Act 2002 regulates the enforcement of certain consumer legislation. It gives the OFT the lead enforcement responsibility for actions taken in the UK, sec 214 (1) of the Enterprise Act 2002.

<sup>920</sup> It is important to note that the guidance on the enforcement provisions of the Enterprise Act, published by the Office of Fair Trading, emphasise that actions must be 'necessary and proportionate' where there is evidence of a breach of a consumer protection law, see: Office of Fair Trading,

OFT has a variety of means to enforce consumer protection legislation. In its statement of the enforcement principles, the OFT emphasises that formal legal action is a last resort.<sup>921</sup> If the OFT applies for an enforcement order, the court may make an enforcement order which must indicate the nature of the conduct to which the order applies.<sup>922</sup> Such an order requires the cessation of the infringement. Failure to comply with the Enforcement Order could be found by a court to be contempt of court, which could lead to a fine or imprisonment.<sup>923</sup>

An important point in this enforcement regime of the regulations is the position of the consumers who are the intended beneficiaries of the Consumer Protection from Unfair Trading Regulations 2008 in particular and of consumer law in general. Part 8 of the Enterprise Act 2002 which provides the enforcement mechanisms for certain consumer laws including the CPRs does not allow consumers to initiate injunctive civil actions themselves. This power is the right of the enforcement authorities, namely the OFT and the trading standard authorities. The civil enforcement of the CPRs therefore lies with public authorities. The consequence of this system is that injunctive civil actions cannot be brought by the consumers themselves as the intended beneficiaries of consumer protection law. Although public authorities have possibly more resources to enforce the CPRs than private individuals, it is a serious weakness of the CPRs that the enforcement of the provision in reg 5 (3) (b) CPRs, with its potential to promote CSR, is subject to the decision of public authorities to take action and not down to the consumers. The consumers cannot decide whether or not they pursue infringements of codes of conduct. This situation means that, where a company has committed an unfair commercial practice through breaching a CSR commitment in a code of conduct which it has adopted, consumers must rely on the OFT and trading standards in terms of enforcement. The consumers themselves do not procure a remedy.

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*Enforcement of consumer protection legislation, Guidance on Part 8 of the Enterprise Act*, available at: [http://www.offt.gov.uk/shared\\_offt/business\\_leaflets/enterprise\\_act/oft512.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft512.pdf) (last accessed: 09/08/2012).

<sup>921</sup> OFT, *Statement of consumer protection enforcement principles*, (February 2012), para 2.14., available at: [http://www.offt.gov.uk/shared\\_offt/reports/consumer\\_protection/OFT1221](http://www.offt.gov.uk/shared_offt/reports/consumer_protection/OFT1221) (last accessed: 10/08/2012). Court action will only be taken after undertakings have been sought, wherever possible. The OFT will therefore usually first consult with the business in question in order to stop the infringement before taking court action by applying for an enforcement order. Applications for an enforcement order are made pursuant to sec 215 of the Enterprise Act 2002 if the enforcer thinks that a person has engaged or is engaging in conduct which constitutes a domestic or a Community infringement, or is likely to engage in conduct which constitutes a Community infringement. Pursuant to s215 (5) (a) Enterprise Act 2002, the High Court or a county court have jurisdiction to make an enforcement order if the person against whom the order is sought carries on business or has a place of business in England and Wales or Northern Ireland.

<sup>922</sup> SS217 (3), (5) CPRs.

<sup>923</sup> Office of Fair Trading, *Enforcement of consumer protection legislation, Guidance on Part 8 of the Enterprise Act*, para 3.51.

The current enforcement regime is a severe limitation for consumers. It does not expose traders who have breached consumer laws to litigation by consumers. The intention not to open floodgates through the introduction of a private remedy has resulted in a situation where the CPRs are only rarely enforced. In its annual report 2011-2012, the OFT declares that it obtained 13 undertakings and 5 court orders through its enforcement of consumer protection laws via its powers in the Enterprise Act 2002. All but one court order concerned the breach of the CPRs.<sup>924</sup> These figures are not particularly high. From a CSR point of view, it can be concluded that whilst the CPRs encompass breaches of CSR through the prohibition of misleading practices, there is currently no effective enforcement regime in place. The potential of the CPRs to promote the socially responsible behaviour of companies, therefore, remains unused.

The background to the absence of a private remedy in English law is that the Unfair Commercial Practices Directive which was implemented through the CPRs gives member states some choice of appropriate domestic enforcement remedies for non-compliance in Articles 11 to 13 of the Directive.<sup>925</sup> The Directive left it to the member states to decide whether or not to introduce a private remedy.<sup>926</sup> It therefore did not harmonise the enforcement systems. The UK decided against such a private remedy for consumers when it implemented the Directive through the CPRs in 2008.<sup>927</sup> However, this decision has not brought the discussion to an end. The absence of an enforcement right for consumers has been subject to much criticism

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<sup>924</sup> See the information provided by the OFT in its annual report: OFT, *Annual Report 2011-12, Annexe A*, available at: [http://www.of.gov.uk/shared\\_of/annual\\_report/2012/annexe-A.pdf](http://www.of.gov.uk/shared_of/annual_report/2012/annexe-A.pdf) (last accessed: 23/08/2012).

<sup>925</sup> Article 11 Enforcement: '1. Member States shall ensure that adequate and effective means exist to combat unfair commercial practices in order to enforce compliance with the provisions of this Directive in the interest of consumers. Such means shall include legal provisions under which persons or organisations regarded under national law as having a legitimate interest in combating unfair commercial practices, including competitors, may: (a) take legal action against such unfair commercial practices; and/or (b) bring such unfair commercial practices before an administrative authority competent either to decide on complaints or to initiate appropriate legal proceedings. It shall be for each Member State to decide which of these facilities shall be available and whether to enable the courts or administrative authorities to require prior recourse to other established means of dealing with complaints, including those referred to in Article 10. These facilities shall be available regardless of whether the consumers affected are in the territory of the Member State where the trader is located or in another Member State.'

<sup>926</sup> Directive 2005/29/EEC, The Consumer Protection From Unfair Trading Regulations 2008. The directive does not preclude member states from conferring a private right of redress on consumers.

<sup>927</sup> The government asked the Law Commission to consider the issue of private enforcement of the regulations. The Law Commission concluded that the introduction of a private remedy for consumers could create more problems than it would solve. See: Law Commission, *A private right of redress for unfair commercial practices? Preliminary advice to the Department of Business, Enterprise and Regulatory Reform*, (November 2008), available at: [http://lawcommission.justice.gov.uk/docs/rights\\_of\\_redress\\_advice1\(2\).pdf](http://lawcommission.justice.gov.uk/docs/rights_of_redress_advice1(2).pdf) (last accessed: 09/08/2012).

and debate.<sup>928</sup> For example, the statutory consumer organisation Consumer Focus called for the introduction of a private right of redress in the CPRs for all consumers after the implementation of the Directive.<sup>929</sup> In its report, Consumer Focus highlighted that there were only relatively few prosecutions under the current regime despite a large number of violations of the CPRs.<sup>930</sup> In a study of the extent of unfair commercial practices, 64 per cent of the respondents said that they had fallen victim to an unfair commercial practice within the past 24 months.<sup>931</sup> Consumer Focus therefore argued that there was an enforcement gap of the existing public enforcement system.<sup>932</sup> This situation would justify providing consumers with a private remedy. The consumer organisation concluded that enforcement would be more effective if public authorities and consumers 'worked in tandem' using both private and public enforcement sanctions against misleading and aggressive trade practices.<sup>933</sup> It would be a distinct advantage of a private remedy that the consumer who is the victim of the misleading information of a company obtains a right of redress against the trader.<sup>934</sup> The existing private law<sup>935</sup> would be uncertain and complex leading to a situation where 'only the most competent of lawyers can offer satisfactory advice to consumers about their rights in the minefield of common and statute law'.<sup>936</sup> Notably, the OFT supported the arguments made by Consumer Focus that consumers should be given a private right of redress for all breaches of the regulations.<sup>937</sup> In 2010, the Department for Business, Innovation and Skills (BIS) asked the Law Commission to conduct a review on the issue of consumer redress for misleading and aggressive practices. Following the publication of a consultation paper in April 2011<sup>938</sup>, the Law Commission published a report in March 2012 with suggestions about the reform of consumer redress for misleading and aggressive practices which is, at the time of writing, still subject to a review by the

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<sup>928</sup> For example: Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009), available at: <http://www.consumerfocus.org.uk/files/2010/12/Waiting-to-be-heard.pdf> (last accessed: 09/08/2012).

<sup>929</sup> Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009) 3.

<sup>930</sup> *ibid.*, 3.

<sup>931</sup> *ibid.*, 9.

<sup>932</sup> *ibid.*

<sup>933</sup> *ibid.*, 3.

<sup>934</sup> *ibid.*, 13.

<sup>935</sup> This is the law of misrepresentation which is discussed in the next section.

<sup>936</sup> Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009) 17.

<sup>937</sup> 'Consumers should have private rights of redress against unfair business practices, OFT says', available at: <http://www.out-law.com/page-12121> (last accessed: 23/08/2012).

<sup>938</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices: A Joint Consultation Paper*, (Consultation Paper No 199 / Discussion Paper 149, April 2011), available at: [http://lawcommission.justice.gov.uk/docs/cp199\\_consumer\\_redress.pdf](http://lawcommission.justice.gov.uk/docs/cp199_consumer_redress.pdf) (last accessed: 09/08/2012).

government.<sup>939</sup> This report and the recommendations which are made therein will be discussed in the final part of this chapter which discusses forward-looking suggestions about how English consumer law could better promote CSR.<sup>940</sup>

In conclusion, the current enforcement regime of the CPRs with its absence of a private remedy to prosecute breaches of consumer laws is severely deficient. Although the CPRs encompass breaches of firm and verifiable CSR commitments in codes of conduct, the consumers as the intended beneficiaries of the CPRs are left without a right of redress against companies. They therefore do not procure an appropriate remedy for unlawful commercial practices.

### 5.3.2 Law of misrepresentation

Consumers could also be protected against breaches of CSR commitments by companies through the law of misrepresentation. The law of misrepresentation is sometimes referred to as the 'pre-existing private law'<sup>941</sup> in respect of consumer actions as it predates the implementation of the CPRs.<sup>942</sup> It is a separate body of law which lies on the boundary of contract, tort and restitution.<sup>943</sup> Despite this situation, the law of misrepresentation will be addressed in this chapter on consumer law and CSR. The reason for this approach is that the law of misrepresentation is said to cover similar ground to the Unfair Commercial Practices Directive 2005/29 in the consumer context.<sup>944</sup> As the law of misrepresentations covers false statements which have induced the party misled into entering into the contract, it could provide consumers with redress in the context of breaches of publicly announced CSR commitments. In this case the law of misrepresentation would protect consumers and hence serve consumer law ends. As the law of misrepresentation could be utilised to protect consumers, textbooks on consumer law consequently often

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<sup>939</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, (Law Com No 332 / Scot Law No 226, March 2012), available at: [http://lawcommission.justice.gov.uk/docs/lc332\\_consumer\\_redress.pdf](http://lawcommission.justice.gov.uk/docs/lc332_consumer_redress.pdf) (last accessed: 09/08/2012).

<sup>940</sup> This section analyses the way how English consumer law currently promotes CSR. The proposals for reform in the Law Commission's report therefore form part of the subsequent discussion about possible changes to the legal status quo.

<sup>941</sup> The law relating to misrepresentation is mainly found in common law with the Misrepresentation Act 1967 providing some further details.

<sup>942</sup> Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009) 17.

<sup>943</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.1. Art 2 (2) of the Unfair Commercial Practices Directive clarifies that the directive is 'without prejudice to contract law and, in particular, to the rules on the validity, formation or effect of a contract'.

<sup>944</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) 23.

contain a section on it.<sup>945</sup> This approach is in line with the view that the scope of consumer law is open-ended.<sup>946</sup>

When the Law Commission was consulted upon the issue of the possible introduction of a private remedy for consumers in the process leading to the implementation of the CPRs, it discussed the remedies which were already available to consumers under the then current legal regime, including remedies based on the law of misrepresentation.<sup>947</sup> This situation is mirrored in the recent consultation and report of the Law Commission on the matter where it again discusses the scope of the law of misrepresentation as legal actions in private law.<sup>948</sup> The discussion of the law of misrepresentation in these documents remains somewhat general, however. In particular, it does not apply the law of misrepresentation to matters of CSR, including breaches of commitments in codes of conduct. In the discussion about the possible introduction of a private remedy, Consumer Focus criticised the complexity of the law of misrepresentation.<sup>949</sup> It argued that there are gaps in terms of the kinds of statements which constitute misrepresentations, for example, statements which are literally true, but misleading, are not covered by the law of misrepresentation, whereas they are under the CPRs.<sup>950</sup> The Law Commission is similarly critical of the law of misrepresentation as the private law way of providing redress to consumers for misleading and aggressive practices.<sup>951</sup> In its final report it states that although the law of misrepresentation would, in theory, provide redress for most misleading trade practices where consumers suffer detriment, it would be 'fragmented, complex and unclear'.<sup>952</sup> Moreover, it would be difficult to apply in a consumer context as it primarily evolved to deal with business disputes.<sup>953</sup>

This section will apply the law of misrepresentation to CSR. It will analyse whether the law of misrepresentation encompasses breaches of corporate CSR

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<sup>945</sup> See G Howells and S Weatherill, *Consumer Protection Law* (2<sup>nd</sup> edn, Ashgate 2005) para 3.4; G Woodroffe and R Lowe, *Woodroffe and Lowe's Consumer Law and Practice* (8<sup>th</sup> edn, Sweet & Maxwell 2010) paras 7.03 – 7.11

<sup>946</sup> G Howells and S Weatherill, *Consumer Protection Law* (2<sup>nd</sup> edn, Ashgate 2005) 5.

<sup>947</sup> Law Commission, *A private right of redress for unfair commercial practices? Preliminary advice to the Department of Business, Enterprise and Regulatory Reform* (November 2008).

<sup>948</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices: A Joint Consultation Paper*, (Consultation Paper No 199 / Discussion Paper 149, April 2011), 54–79; The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, (Law Com No 332 / Scot Law No 226, March 2012) 23–40.

<sup>949</sup> Consumer Focus, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (August 2009) 17.

<sup>950</sup> *ibid*, p 18.

<sup>951</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) x.

<sup>952</sup> *ibid*.

<sup>953</sup> *ibid*.



commitments in codes of conduct and, if it does, if consumers procure an appropriate remedy.

### **5.3.2.1 Are breaches of CSR commitments by companies covered?**

Following the case study of the ETI Base Code in the previous section on the CPRs, the law of misrepresentation will be applied here to the same clauses of this code, used as an example of an important code of conduct to which many English companies selling consumer goods are committed.

The clauses from the ETI Base Code used above are:

- 1. Employment is freely chosen**
  - 1.1. There is no forced, bonded or involuntary prison labour.
- 2. Freedom of association and the right to collective bargaining are respected**
  - 2.1. Workers, without distinction, have the right to join or form trade unions of their own choosing and to bargain collectively.
  - 2.2. The employer adopts an open attitude towards the activities of trade unions and their organisational activities.
- 4. Child labour shall not be used**
  - 4.1. There shall be no new recruitment of child labour.
- 6. Working hours are not excessive**
  - 6.2. In any event, workers shall not on a regular basis be required to work in excess of 48 hours per week and shall be provided with at least one day off for every 7 day period on average. Overtime shall be voluntary, shall not exceed 12 hours per week, shall not be demanded on a regular basis and shall always be compensated at a premium rate.

A misrepresentation can be defined as an unambiguous, false statement of fact or law which is addressed to the party misled, which is material and which also induces the contract.<sup>954</sup>

#### **5.3.2.1.1 An unambiguous, false statement of fact**

The first condition is that there is an unambiguous, false statement of existing fact or law.<sup>955</sup> There is no further definition of 'statement of fact' in cases dealing with alleged misrepresentations other than that these statements are distinguished from the following statements which do not constitute statements of fact: statements of

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<sup>954</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.2.

<sup>955</sup> Following *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, mistakes of law can also cause an actionable misrepresentation.

opinion, 'mere puffs' and statements of intention or promises.<sup>956</sup> Companies commonly communicate their CSR policies on their website, in brochures or other public relations material.<sup>957</sup> The CSR communication is easily available by consumers. In these documents companies make statements about how they behave in socially responsible ways. As mentioned above, codes of conduct usually form a core element of the CSR policy of companies.<sup>958</sup> These codes of conduct regularly contain a list of CSR commitments to which companies pledge to comply. It depends on the way the commitments are phrased themselves, if they are to be regarded as statement of facts for the purpose of the law of misrepresentation or if they are rather statements of intention or promises (which, even if untrue, could not qualify as misrepresentations). In the above examples from the ETI Base Code, the clauses pertaining to the prohibition of forced labour and the recruitment of new child labour as well as the granting of the right to join a trade union are all firm and verifiable statements and not just statements of intention. They therefore constitute statements of fact. The assessment of the principle referring to the activities of trade unions leads to a different outcome, however. The wording 'open attitude to the activities' is not as definite as the previous examples. A company such as River Island could claim that it pursues this goal even though it does exercise certain restrictions on these activities in practice in a perhaps more subtle way. In conclusion, breaches of the clause pertaining to the activities of trade unions are hard to verify. It would be difficult to prove that this clause was a false statement. This clause can therefore rather be interpreted to be a promise.

Overall, this analysis mirrors the assessment of the same principles of the ETI Base Code with regard to the CPRs. If a company such as River Island was found to be in breach of the commitments pertaining to the use of child labour or forced labour or the right to join a trade union, then this breach would constitute an unambiguous, false statement of fact.

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<sup>956</sup> See J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 14.2.1.3.

<sup>957</sup> For example, River Island as an ETI member has published information about its CSR engagement and the ETI on a special section on its website (the website also has an online shop): <http://www.riverisland.com/inside-river-island/about-us/ethical-trading-initiatives> (last accessed: 19/03/2013). Another example is Unilever which has published a brochure about its CSR engagement: Unilever, *CSR: Rebuilding Trust in Business, A Perspective of Corporate Social Responsibility in the 21<sup>st</sup> Century*, available at:

[http://www.unilever.com/Images/A%20Perspective%20on%20Corporate%20Social%20Responsibility%20in%20the%2021st%20Century\\_tcm13-5520.pdf](http://www.unilever.com/Images/A%20Perspective%20on%20Corporate%20Social%20Responsibility%20in%20the%2021st%20Century_tcm13-5520.pdf) (last accessed: 21/08/2012)

<sup>958</sup> See for example: Vodafone, *The Vodafone Code of Conduct*, available at:

[http://www.vodafone.com/content/dam/vodafone/uk\\_cr/vodafone\\_code\\_of\\_conduct.pdf](http://www.vodafone.com/content/dam/vodafone/uk_cr/vodafone_code_of_conduct.pdf) (last accessed: 21/08/2012).

### 5.3.2.1.2 The representation must have been addressed to the party misled

The second requirement of misrepresentations is that the representation must have been addressed to the party misled. The statement can be addressed through direct communication of the misrepresentation or alternatively by addressing it to a third party with the intention of it being passed on to the claimant.<sup>959</sup> The CSR policies of the companies are publicly communicated in order to enhance the brand reputation vis-à-vis the companies' (present and potential) customers, for example the section on the ETI on River Island's website. This condition is satisfied whenever information about the companies' CSR policies is directed to consumers.

### 5.3.2.1.3 The representation must have induced the other party to enter into the contract

The third condition is that the representation must have induced the other party to enter into the contract and possibly it must have also been a material misrepresentation.<sup>960</sup> The misrepresentation does not need to be the sole inducement; it is sufficient to be an inducement which was actively present to the representee's mind.<sup>961</sup> It must represent a fact which would positively influence a reasonable person who considers entering the contract to decide positively in favour of so doing.<sup>962</sup> The consumer will be unable to show that the representation induced the contract where the consumer was unaware of the existence of the representation, where he knew that the representation was untrue and where he did not allow the representation to affect his judgment. The latter is the case where the claimant regards the representation as being unimportant.<sup>963</sup> A study has shown that up to 90% of consumers consider the CSR record of companies in their purchase and consumption behaviours.<sup>964</sup> Although other studies have revealed that the actual purchase decision is only rarely based on CSR considerations<sup>965</sup>, it is proven

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<sup>959</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.4.

<sup>960</sup> *ibid*, para 13.5. The requirement of the misrepresentation being material is doubted. It seems as if courts now no longer distinguish between materiality and inducement. The situation is now that if the misrepresentation would have induced a reasonable person to enter into the contract, then the courts will presume that it did induce the representee to enter into the contract and the onus of proof is then placed upon the representor to show that the representee did not in fact rely on the representation. On the other hand, where the misrepresentation would not have induced a reasonable person to enter into the contract, then the onus of proof is on the representee to show that the misrepresentation did in fact induce him to enter into the contract.

<sup>961</sup> *Edgington v Fitzmaurice* (1885) 29 Ch D 459.

<sup>962</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 14.2.2.1.

<sup>963</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.5.

<sup>964</sup> D Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution 2005).

<sup>965</sup> M Carrington, B Neville and G Whitwell, 'Why Ethical Consumers Don't Walk Their Talk: Towards a Framework for Understanding the Gap Between the Ethical Purchase Intentions and Actual Buying Behaviour of Ethically Minded Consumers', (2010) 97 *Journal of Business Ethics* 139; G Eckhardt, R Belk and T Devinney, 'Why don't consumers consume ethically?' (2010) 9 *Journal of Consumer Behaviour* 426.

that CSR generally positively influences consumers. CSR commitments are therefore facts which would positively influence a reasonable person in favour of entering a contract which the person considers entering into anyway. It is therefore likely that CSR commitments are considered to be representations which have induced the other party into the contract.

In conclusion, the law of misrepresentation encompasses breaches of CSR commitments by companies, if customers can prove that they were influenced in their purchase decision by the CSR commitments of a company. The important condition is that the CSR commitment in question must be a false statement of fact. As shown in the analysis of the ETI Base Code this condition is not satisfied in respect of all CSR principles in this code of conduct. The results in relation to the scope of the law of misrepresentation and the CPRs is similar, as the same CSR commitments were found to be encompassed by the two different legal sources. This finding seems to confirm the contention found in the Law Commission's review that the law of misrepresentation would cover the breaches of CSR commitments in private law which are prohibited by the CPRs.<sup>966</sup>

However, it is important to consider that the existence of a misrepresentation depends on whether the consumer has been induced to enter into a contract. Private law claims based on misrepresentation therefore presuppose that a contract was formed in the first place.<sup>967</sup> This situation is a difference to the CPRs which only require that the failure to comply with a commitment in a code of conduct 'causes or is likely to cause the average consumer to take a transactional decision he would not have taken otherwise'. Injunctions against companies for breach of the CPRs, following the violation of their codes of conduct, are therefore possible without a previously formed contract if the breach was likely to cause the average consumer to make a purchase decision on this basis. In contrast, misrepresentations only exist where a consumer has indeed purchased a good. The law of misrepresentation therefore does not encompass breaches of CSR to the same extent as the CPRs.

Finally, another important point to consider with regard to claims in private law is that complaints should be raised with the retailer who then passes the issue up the chain. The reason for this situation is that the contract is not formed between the consumer and the company which is in breach of its CSR commitments, but between the consumer and the retailer. If, for instance, the consumer obtains a right

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<sup>966</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) 10.

<sup>967</sup> The supply chain contracts in the previous chapter also require the formation of a contract in order to give effect to the CSR policies which the buyer imposes on the supplier.

to rescind the contract, then the retailer will have to follow this up with the manufacturer.

### **5.3.2.2 Do consumers procure an appropriate remedy for a misrepresentation?**

The law of misrepresentation only promotes CSR in a meaningful way if consumers procure an appropriate remedy where a company is found to have committed a misrepresentation by breaching a CSR principle in its code of conduct. It is necessary to distinguish which type of misrepresentation is at issue in order to determine the remedial consequences of the breach. A distinction is made between fraudulent misrepresentations<sup>968</sup>, negligent misrepresentations in common law, misrepresentations which are liable under section 2 (1) of the Misrepresentation Act 1967 and innocent misrepresentations which are neither fraudulent, nor negligent.<sup>969</sup>

#### **5.3.2.2.1 Right to rescind the contract**

All types of misrepresentation entitle the representee to rescind the contract (i.e. setting aside the contract which was subject to the misrepresentation), but not all types of misrepresentation give rise to an action for damages.<sup>970</sup> A misrepresentation renders the contract voidable.<sup>971</sup> If a contract is voidable, the representee can decide either to rescind or to affirm the contract.<sup>972</sup> The availability of the right to rescind the contract, upon finding a misrepresentation, is a powerful tool for consumers. It enables them to decide whether or not to keep the contract. Consumers have the right to be put back into the position they were in before entering into the contract under the influence of the misrepresentation, i.e. the false belief that a company complies with its CSR commitments, although, in fact, it does not adhere to these. The company, on the other hand, faces a severe consequence in case of such a misrepresentation, i.e. to lose its contracts with consumers who considered the accuracy of the company's CSR commitments to be an important aspect for their purchase decision. The law of misrepresentation therefore provides an appropriate remedy in case of breaches of CSR commitments through the availability of the right to rescind the contract.<sup>973</sup>

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<sup>968</sup> Fraudulent misrepresentations also constitute the tort of deceit. Following *Derry v Peek* (1889) 14 App Cas 337, in order to be fraudulent the false statement must be made knowingly or without belief in its truth or recklessly, careless whether it be true or false.

<sup>969</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2012) para 14.4.

<sup>970</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.6.

<sup>971</sup> *ibid.*

<sup>972</sup> *ibid.*

<sup>973</sup> However, one needs to take into account that there has not been a single case yet. The absence of any relevant case law questions the ability of the law of misrepresentation to adequately protect

### 5.3.2.2 Right to damages

Apart from rescission the other principal remedy for misrepresentation is damages. A claim for damages cannot be based on contract unless the misrepresentation has been subsequently incorporated into the contract as a term, in which case damages can be claimed for breach of contract. But damages can be recovered in tort where the misrepresentation was made fraudulently or negligently.<sup>974</sup> Fraud will be difficult to prove in respect of breaches of CSR commitments, however, as this would presuppose that the company has made the false statements 'knowingly, or without belief in its truth, or recklessly, careless whether it be true or false'.<sup>975</sup> Negligent misrepresentations are misrepresentations made without due care. They can either be based on common law or on the Misrepresentation Act 1967. Those which are based on common law require the existence of a duty of care.<sup>976</sup> This requirement of a duty of care establishes an extra hurdle which a consumer must overcome who makes a claim for damages. Such a special relationship is not necessary for a misrepresentation pursuant to s2 (1) of the Misrepresentation Act 1967 which entitles the representee to damages.<sup>977</sup> Provided that there is no double recovery, the right to damages is additional to the right to rescission.<sup>978</sup> This Act also reverses the burden of proof to the advantage of the consumer. Once the consumer (the representee) has established the existence of a false statement of fact which induced him into entering into the contract, the defendant (the representor) must prove that that he had 'reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true'.<sup>979</sup> This reversal of the burden of proof is a considerable advantage for the representee (consumer) who makes a claim to be awarded damages. The final category is innocent misrepresentations. These are false statements which were neither made fraudulently nor negligently.<sup>980</sup> Victims of innocent misrepresentations are entitled to rescission of the contract, but they have no right to damages.<sup>981</sup> However, the court

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consumers in relation to breaches of CSR commitments by companies. This issue will be discussed below.

<sup>974</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.9.

<sup>975</sup> *Derry v Peek* (1889) 14 App Cas 337.

<sup>976</sup> *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

<sup>977</sup> S2 (1) of the Misrepresentation Act 1967 provides: 'Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true.'

<sup>978</sup> S2 (2) of the Misrepresentation Act 1967.

<sup>979</sup> S2 (1) of the Misrepresentation Act 1967.

<sup>980</sup> J Poole, *Textbook on Contract Law* (11<sup>th</sup> edn, OUP 2008) para 14.4.4.

<sup>981</sup> *ibid.*

has discretion under s2 (2) of the Misrepresentation Act 1967 to award damages in lieu of rescission in this instance.

Damages compensate the consumer for the financial loss he has suffered.<sup>982</sup> It is necessary to distinguish between the different types of misrepresentation in order to consider the entitlement of a consumer to damages.<sup>983</sup> With regard to the Misrepresentation Act 1967 as the most likely base for such a claim, the measure of damages is the reliance measure.<sup>984</sup> The claimant is put into the same position he would have been in had the misrepresentation not been made as he relied upon the truth of the statement. It is, however, doubtful if there are many instances where consumers would need to claim damages in order to be restored to their original position if they have been the victim of a misrepresentation. In most cases where a consumer has purchased a product from a company, he would be able to claim back the money he paid for the good as a consequence of the rescission. The return of the purchase price will commonly put the consumer back into his original position. For instance, where a consumer purchases a product from River Island because of River Island's commitment not to use forced labour, he would be able to claim back the purchase price through rescission if River Island were to be found to be in breach of this commitment. The return of the purchase price would put the consumer back into the position he was in prior to the purchase of the good from River Island.

However, a hypothetical situation where a consumer would not be fully restored to his original position through rescission is where the consumer incurred further expenses when purchasing a good from a company which he believes to have a positive CSR record due to the information released by that company. In this example, further expenses might be incurred if the product from this particular company is not available in the city where the consumer lives, but only further away and if the consumer then travels to that place for making the purchase. This situation might occur in respect of the garment industry in case of expensive high-end clothes which have a smaller customer base and are therefore not sold as widely as cheaper competitors. It is unlikely that this situation would occur in relation to goods produced by a company such as Unilever as these are mainly foods, refreshments, homecare or personal care, hence products used on a daily basis which are usually available in most supermarkets. So, if in this hypothetical example

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<sup>982</sup> E McKendrick, *Contract Law* (8<sup>th</sup> edn, Palgrave Macmillan 2009) para 13.7.

<sup>983</sup> *ibid*, para 13.9.

<sup>984</sup> *Roycot Trust Ltd v Rogerson* [1991] 2 QB 297; *Sharneyford Supplies Ltd v Barrington Black and Co* [1987] Ch 305, 323.

a CSR-conscious consumer who lives in Sheffield deliberately chooses to buy clothes from a particular brand which is only sold in London, then this consumer incurs further travel expenses. If the company which has produced the clothes and which proclaims to have a good CSR record is later on found to be in breach of its CSR commitments, then the consumer would have suffered a loss through the extra travel expenses which will not be recoverable by rescission.

The fact that consumers not only procure a right to rescind the contract, but also to damages where they have made a loss as a consequence of the misrepresentation provides the consumers with an appropriate range of remedies. If they have fallen victim to a company which is in breach of CSR commitments that it has undertaken to comply with, then the consumers will be able to be restored into their position prior to the misrepresentation. However, in most cases, consumers will not need to use the right to damages in relation to the breach of CSR commitments as the rescission will put them back into their original position and as double recovery is not permitted.

### **5.3.2.3 The ability of the law of misrepresentation to promote CSR**

Although this analysis has shown that the law of misrepresentation covers breaches of CSR commitments by corporations and also provides an appropriate remedy for consumers in such a situation, the ability of the law of misrepresentation to promote consumer protection is limited. Both Consumer Focus and the Law Commission are right in their criticism that the law of misrepresentation is a somewhat complicated way for consumers to procure a remedy for misleading practices such as breaches of CSR commitments by companies. The analysis in this section has shown that the main drawback of the law of misrepresentation is its rather abstract nature. Its sources can mainly be found in the common law with some codification in the Misrepresentation Act 1967. The law of misrepresentation is therefore less accessible than a designated Consumer Act in this field would be. In comparison, the CPRs are written in a very detailed manner and their sole purpose is to protect consumers. There is also guidance on the application of the CPRs with examples, provided by the OFT, which makes it easier both for laypeople and lawyers to consider their application to business to consumer transactions. The law of misrepresentation is therefore a less obvious legal basis for consumer claims. Although consumers can use the law of misrepresentations as a means to procure private redress, the complex nature of this legal area is likely to limit its ability to promote CSR meaningfully. It is therefore noticeable that the research for this chapter has not found a single case where a consumer has made a claim for a



misrepresentation based on the breach of a CSR commitment by a company. The absence of applicable case law in respect of breaches of CSR commitments is an indication that the law of misrepresentation seems to be difficult to understand and to apply in this area. It would be preferable for consumers if the CPRs or a new Act based on the CPRs would provide consumers with the private remedies which are currently only found in the law of misrepresentation.

### **5.3.3 Business Protection from Misleading Marketing Regulations 2008**

Advertisement regulation, particularly the Business Protection from Misleading Marketing Regulations 2008<sup>985</sup>, also address misleading advertisement practices in corporate communications. These laws could also encompass the breach of a CSR commitment by a company with which it publicly declares to comply. However, as the Business Protection from Misleading Marketing Regulations 2008 apply only to business-to-business relationships they are not part of consumer law and hence beyond the scope of this chapter.

## **5.4 How could English consumer law better promote CSR?**

This chapter has shown that English consumer law provides some private law protection for consumers through the law of misrepresentation. However, the law of misrepresentation is less accessible than a designated Act such as the CPRs would be. The situation that the CPRs only protects consumers against breaches of publicly made CSR commitments by companies through public enforcement is a serious drawback for the ability of English consumer law to promote the socially responsible behaviour of companies. As indicated above, there is an ongoing discussion about the question of whether a private remedy for consumers should be introduced into English consumer law. This section will discuss how English consumer law could better promote CSR in private law. The discussion will particularly engage with the recommendations which were made by the Law Commission in March 2012.

### **5.4.1 Background to the recommendations of the Law Commission**

Calls for the introduction of a private remedy for consumers for misleading and aggressive practices were not just made domestically by Consumer Focus and the OFT, but also at the European Union level. For example, the European Parliament passed a resolution in January 2009 which asks member states 'to consider the

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<sup>985</sup> The regulations implement Directive 2006/114/EC concerning misleading and comparative advertising and on unfair commercial practices affecting businesses.

necessity of giving consumers a direct right of redress in order to ensure that they are sufficiently protected against unfair commercial practices'.<sup>986</sup> And in July 2010, the European Parliament's Internal Market and Consumer Protection Committee identified a private right of redress as one of the options for improving the enforcement of the Unfair Commercial Practices Directive.<sup>987</sup> The Law Commission published preliminary advice on the issue in November 2008 before the implementation of the Directive into domestic English law.<sup>988</sup> The Law Commission then stated that a private right of redress could be beneficial to consumers, seeing that Ireland had included such a private remedy in its implementation of the Directive.<sup>989</sup> Nevertheless, the Law Commission was concerned that such an introduction could cause significant problems.<sup>990</sup> It rather suggested improving and simplifying the existing law of misrepresentation. In February 2010, BIS asked the Law Commission and Scottish Law Commission to advise, inter alia, on the possible restatement and simplification of the law of misrepresentation and to reconsider the introduction of a private right of redress where there is clear evidence that consumers have suffered loss as a result of an unfair commercial practice and where no private remedy currently exists.<sup>991</sup> The Law Commission then consulted on the introduction of a private remedy and published a consultation paper to that effect in April 2011.<sup>992</sup> The respondents overwhelmingly supported the view of the Law Commission that reform was needed and that a private right to redress was missing under the existing law. The Law Commission has now published its report in March 2012 which, at the time of writing, is under review by the government.<sup>993</sup> At about the same time, the European Commission reviewed the application of the Unfair Commercial Practices Directive, as stipulated by Article 18 of the Directive. In its

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<sup>986</sup> European Parliament, 'Resolution on the Transposition, Implementation and Enforcement of Directive 2005/29/EC and Directive 2006/114/EC' (13 January 2009) para 12, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:046E:0026:0030:EN:PDF> (last accessed: 19/08/2012).

<sup>987</sup> Internal Market and Consumer Protection Committee, *State of play of the implementation of the provisions on advertising in the unfair commercial practices legislation* (July 2010) para 2.6.2., available at: <http://www.europarl.europa.eu/document/activities/cont/201007/20100713ATT78792/20100713ATT78792EN.pdf> (last accessed: 19/08/2012).

<sup>988</sup> Law Commission, *A private right of redress for unfair commercial practices? Preliminary advice to the Department for Business, Enterprise and Regulatory Reform on the issues raised* (November 2008).

<sup>989</sup> Irish Consumer Protection Act 2007, s 74.

<sup>990</sup> Law Commission, *A private right of redress for unfair commercial practices? Preliminary advice to the Department for Business, Enterprise and Regulatory Reform on the issues raised* (November 2008) para 4.19.

<sup>991</sup> 'Law Commissions consult on creating new consumer right', 12 April 2010, available at: <http://www.out-law.com/page-10911> (last accessed: 23/08/2012).

<sup>992</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices: A Joint Consultation Paper*, (Consultation Paper No 199 / Discussion Paper 149, April 2011).

<sup>993</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, (Law Com No 332 / Scot Law No 226, March 2012).

communication and the accompanying report, published in March 2013, the Commission concludes that it would be inappropriate to amend the Directive as the enforcement experience in the Member States was still too limited.<sup>994</sup> However, whilst the Commission notes that, generally, member states and stakeholders consider the enforcement of the Directive at national level to be 'appropriate and effective', some would be critical of the 'lack of resources of national enforcers', the 'complexity/length of enforcement procedures' and the 'insufficient deterrent effect of the penalties'.<sup>995</sup>

In its review, the Law Commission recommends 'targeted reform'.<sup>996</sup> It is suggested that consumers should not automatically have a private right of redress because there has been a breach of the Regulations, but only 'where there is a clear problem in the marketplace'.<sup>997</sup> The recommendations propose the introduction of a new statutory right of redress for a consumer against a trader in private law for consumers who have suffered from misleading and aggressive trade practices. The new law should be simple and accessible.<sup>998</sup> The consumer would need to show a) that the trader carried out a misleading or aggressive practice, b) that this was likely to cause the average consumer to take a decision to enter into a contract or make a payment they would not have taken otherwise and c) that the misleading or aggressive practice was a significant factor in the consumer's own decision to enter into the contract or make the payment. The definition of misleading practices in reg 5 (2) (a) CPRs would be followed in its substance in that a commercial practice is misleading if it contains false information, or if it is likely to mislead the average consumer in its overall presentation. The average consumer is 'reasonably well-informed, reasonably observant and circumspect'.<sup>999</sup> The Law Commission is of the opinion that the recommended new right covers substantially the same ground as the Misrepresentation Act 1967. Under these proposals the common law of misrepresentation would remain, but the proposed legislation should replace the provisions of the Misrepresentation Act insofar as they cover business-to-consumer

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<sup>994</sup> European Commission, 'Communication on the application of the Unfair Commercial Practices Directive: Achieving a high level of consumer protection, Building trust in the Internal Market' COM (2013) 138 final 9, available at: [http://ec.europa.eu/justice/consumer-marketing/files/ucpd\\_communication\\_en.pdf](http://ec.europa.eu/justice/consumer-marketing/files/ucpd_communication_en.pdf) (last accessed: 27/05/2013).

<sup>995</sup> European Commission, 'First Report on the application of Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive')' COM (2013) 139 final 27, available at: [http://ec.europa.eu/justice/consumer-marketing/files/ucpd\\_report\\_en.pdf](http://ec.europa.eu/justice/consumer-marketing/files/ucpd_report_en.pdf) (last accessed: 27/05/2013).

<sup>996</sup> *ibid.*, xii.

<sup>997</sup> *ibid.*

<sup>998</sup> *ibid.*, xiii.

<sup>999</sup> As in reg 2 (2) CPRs.

transactions. Under the proposals consumers would have two tiers of remedies.<sup>1000</sup> Tier 1 remedies would be the standard remedies and they would apply on a strict liability basis. The consumer would have the remedy to rescind the contract, i.e. both parties are released from their obligations (if any) and the consumer would get a refund, up to three months, provided some element of the product is either returned or rejected. After three months, or if the product is fully consumed, the consumer would be able to claim a discount on the price. The amount of money would be based on the price paid and would not require evidence of loss. The claims could be used both in civil courts and alongside enforcement action, for example in criminal compensation orders. Tier 2 orders would only be available where the consumer proves additional loss. These tier 2 orders cover indirect economic losses and provide damages for distress and inconvenience. The tier 2 orders are also subject to the trader's due diligence defence. The recommendations suggest that consumers should only have a claim where they have entered into a contract with the business in the first place.

The new Act with the recommended changes made by the Law Commission would, if implemented, not replace the CPRs.<sup>1001</sup> These would continue to govern public enforcement in relation to aggressive and misleading practices. The new Act, however, would cover the private law consequences when traders are found to act in ways which are found to be aggressive or misleading. This new regime would apply to business-to-consumers transactions only.<sup>1002</sup> This situation would mean that whilst the CPRs themselves will not gain a private law dimension, they would be complemented by a new private law regime based on them. The Law Commission stated in its report that it hoped that the recommendations, including the private remedy, would be included in the planned Consumer Bill of Rights.<sup>1003</sup>

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<sup>1000</sup> *ibid*, xv.

<sup>1001</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, (Law Com No 332 / Scot Law No 226, March 2012), Part 5: Recommendations: An overview, 52.

<sup>1002</sup> According to the Law Commission's suggestions, rights of action should not expand against others in the supply chain, such as producers. Consumer law would therefore continue not to have an impact on supply chain relationships, if these proposals were implemented. The Law Commission did not include a draft Bill into its review. The reason for this is that the Law Commission hopes that its proposals will be included into the new Consumer Bill of Rights which was proposed by the government. The aim of the Bill is to bring together consumer law from 12 Acts and Regulations. It will also include the European Consumer Rights Directive which was adopted in November 2011. See: Department for Business, Innovation and Skills Press Notice, '*New bill will strengthen consumer rights*' (19 September 2011): 'Edward Davey has today announced a new Consumer Bill of Rights, which will streamline confusing and overlapping legislation and regulation, and provide stronger consumer protection.', available at:

<http://news.bis.gov.uk/content/detail.aspx?NewsAreaId=2&ReleaseID=421254&SubjectId=15&DepartmentMode=true> (last accessed: 19/08/2012).

<sup>1003</sup> The government plans to introduce a Consumer Bill of Rights. Consultations were undertaken to that end, for example on reforms to unfair contract terms law. The Bill of Rights will also include the

In essence, the proposals would provide consumers with a private remedy if they are victims of misleading trade practices. This will primarily be the right to rescission, but if the consumers prove additional loss they would also have a right to damages.

#### **5.4.2 Does the recommended liability regime encompass breaches of CSR commitments?**

From a CSR point of view, the important issue is if the proposed changes will encompass breaches by companies of their CSR commitments (as the CPRs do) and if the consumers will also procure an appropriate remedy in such a situation (which they do not under the CPRs).

The proposed changes will establish liability of companies if the consumer can show the following:

- (1) The trader carried out a misleading or aggressive practice.
- (2) This was likely to cause the average consumer to take a decision to enter into a contract or make a payment they would not have taken otherwise.
- (3) The misleading or aggressive practice was a significant factor in the consumer's own decision to enter into the contract or make the payment.

First of all, breaches of the CSR commitments of a company would need to be a misleading practice. Under the regime of the CPRs a misleading practice is, inter alia, the failure of a trader to comply with a commitment contained in a code of conduct with which the trader has undertaken to comply, if certain further requirements pursuant to reg 5 (3) (b) CPRs are met.<sup>1004</sup> The Law Commission proposes that the new Act would follow the substance of the definition of misleading practice in reg 5 (2) CPRs by stating that a commercial practice is misleading if it contains false information, or if it is likely to mislead the average consumer in its overall presentation.<sup>1005</sup> The Law Commission opined that whilst examples may be useful to explain new concepts, the idea of a misleading practice was well-established. Hence, it recommends keeping the new definition of misleading practices short and general. In its view, the lists of matters about which misleading

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European Consumer Rights Directive. See: <https://www.gov.uk/government/policies/providing-better-information-and-protection-for-consumers/supporting-pages/personal-data> (last accessed: 18/03/2013).

<sup>1004</sup> These are a) The trader must indicate in a commercial practice that he is bound by that code of conduct, b) the commitment must be firm and capable of being verified and it must not be aspirational and c) the commitment must cause or be likely to cause the average consumer to take a transactional decision he would not have taken otherwise, taking account of its factual context and of all of its features and circumstances.

<sup>1005</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) para 5.9.

representations may be made should not be replicated.<sup>1006</sup> It argues that there was no need to make 'separate provision for codes of practice'.<sup>1007</sup> So, whilst these deliberations of the Law Commission suggest that the new definition is unlikely again to contain the example of a misleading practice through breach of a commitment in a corporate code of conduct currently found in reg 5 (3) (b) CPRs, such breaches would continue to be a misleading practice. A breach of a firm and verifiable commitment in a code of conduct is false information. However, it is questionable if the definition of misleading practices is indeed as well-established as claimed, particularly as consumers do not enjoy any private remedy under the CPRs. While the Law Commission is right that the list of matters in reg 5 CPRs makes the definition of misleading actions longer, it is doubtful whether this situation is necessarily negative, particularly from a CSR point of view. The examples in the CPRs provide guidance to both lawyers and laypeople about the instances which constitute misleading actions, including the breach of a commitment in a code of conduct. As such a breach of a commitment in a code of conduct has so far not led to any case law, it is, from a CSR point of view, a negative development if codes of conduct are no longer explicitly mentioned in the proposed new definition. There is a danger that consumers might not be aware that such breaches can constitute misleading actions. Hence, the recommended short and general definition of misleading actions could, in fact, make the law less accessible and reduce the likelihood of claims being brought for breaches of CSR commitments despite the Law Commission's contention that the same kind of actions would continue to be a misleading action.

The second condition of the proposed definition of misleading actions focusses on the impact of the misleading practice on the average consumer. It must be likely that the misleading action has caused the average consumer to take a decision to enter into a contract or make a payment they would not have taken otherwise. The term 'average consumer' mirrors the requirement in the CPRs which stipulates that the 'average consumer' is 'reasonably well informed, reasonably observant and circumspect'.<sup>1008</sup> The Law Commission recommends keeping this definition of an average consumer under the new Act.<sup>1009</sup> Breaches of CSR commitments in codes of conduct must have caused this hypothetical consumer to take a decision he

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<sup>1006</sup> *ibid*, para 5.11.

<sup>1007</sup> *ibid*, para 7.56.

<sup>1008</sup> Reg 2 (2) CPRs.

<sup>1009</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) para 5.14.

would otherwise not have taken. This standard is an objective one.<sup>1010</sup> In *Office of Fair Trading v Purely Creative Ltd*<sup>1011</sup>, the High Court emphasised that there is a proposition that the Unfair Commercial Practices Directive, which underlies the CPRs, would protect consumers who take reasonable care of themselves.<sup>1012</sup> As the Law Commission recommends basing the requirements for misleading actions under the new Act on the existing law in the CPRs, the example in the guidance of the OFT in relation to reg 5 (3) (b) CPRs regarding the breach of a commitment in a code of conduct would continue to apply. This example states that an average consumer would expect code members to sell products which comply with their code and that an average consumer would buy these products on that basis.<sup>1013</sup> Moreover, as studies have revealed that the majority of consumers consider CSR issues in their purchase decisions, one can assume that, as a reasonably well-informed person, the average consumer would expect a company to comply with its publicised CSR commitments when deciding whether or not to purchase goods from that company. Breaches of codes of conduct will therefore satisfy this second condition under the new regime.

The third condition of the new Act, i.e. that the misleading practice was a significant factor in the consumer's own decision to enter into the contract, requires the consumer to prove that his individual purchase decision was significantly influenced by the CSR commitments publicised by that particular company. The consumer must be able to prove the importance he has attached to the socially responsible conduct of the company from which he chose to purchase the product. Consumers who would make a claim for rescission and/or damages in private law due to the breach of CSR commitments are likely to have been significantly influenced in their personal purchase decision by the company's CSR record. Moreover, reg 5 (3) (b) CPRs stipulates that the breach of a firm and verifiable commitment has caused or is likely to cause the average consumer to take a transactional decision would not have taken otherwise. The condition under the new Act would therefore not impose a higher threshold.

In conclusion, although the suggested new liability regime in private law would mirror the CPRs in most respects, there are some slight differences which are significant from a CSR point of view. First of all, as mentioned above, the

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<sup>1010</sup> *ibid*, para 5.14.

<sup>1011</sup> *Office of Fair Trading v Purely Creative Ltd* [2011] EWHC 106 (Ch).

<sup>1012</sup> In its preliminary ruling in this case, the ECJ emphasised that it is for the national courts to establish the typical reaction of the average consumer in a case, see: *Purely Creative Ltd and Others v Office of Fair Trading*, (Case C-428/11), [2013] 1 C.M.L.R. 35.

<sup>1013</sup> OFT, *Guidance on Consumer Protection from Unfair Trading Regulations* (2008) para 7.11.

recommended short definition of misleading actions would be shorter than the current, rather detailed definition. As breaches of codes of conduct have so far not been adequately followed up under the CPRs, it is not to be expected that many lawyers, let alone consumers, know that such conduct constitutes a misleading action. The recommended short definition is therefore likely to reduce the chances that claims based on breaches of codes of conduct are brought. Secondly, whilst it is sufficient under the CPRs that the breach of a code of conduct 'causes or is likely to cause' the average consumer to make a purchase decision, the proposed new Act would require the formation of a contract in the first place for misleading actions.<sup>1014</sup> This change will reduce the number of potential claims. Breaches of commitments made in codes of conduct will therefore not constitute misleading actions to the same extent as the CPRs do.

#### **5.4.3 Does the recommended liability regime provide an appropriate remedy?**

However, the important question in terms of the ability of this new Act to promote CSR through consumer law is if consumers would also procure an appropriate remedy for breaches of CSR commitments. The key difference to the CPRs is that the new Act would be subject to private enforcement. The principal right of the consumer to rescind the contract under this proposed regime would be a strong tool as a rescission puts the consumer into the position he would have been had he not entered into the contract. The right to rescind the contract for consumers would also constitute some form of deterrent for traders not to engage in misleading and aggressive practices. The alternative right for consumers to a discount where three months have lapsed or the good has been consumed appears to be reasonable, taking into account the interest of the company which has sold the good and the consumer who has had time to make his claim or who has already consumed the good. The division into two tiers of remedies creates a balanced system. The additional remedy under the second tier of remedies to damages for indirect economic losses, including distress and inconvenience, presupposes that the trader can prove that the misleading practice caused actual loss. The fact that this remedy is more difficult to procure does not constitute a significant disadvantage for the position of consumers. If the consumer has, in fact, suffered a detriment from purchasing a good then he should be able to obtain a right to damages under this system and, where he has not suffered a loss, it would be reasonable for him to make a claim for rescission only. The analysis above has shown that, in most cases,

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<sup>1014</sup> The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices* (Law Com No 332 / Scot Law No 226, March 2012) para 5.5.



the consumer will only have a right to rescission and not a further right to damages. The proposed new Act would therefore provide consumers with appropriate remedies in case of a breach of CSR commitments by a company. Although the new Act would significantly overlap with the law of misrepresentation which already covers such breaches of CSR commitments and provides similar remedies, the key difference will be that the new Act would be more accessible for laypeople and lawyers alike.

It is a weakness of the recommend regime that it does not suggest the introduction of civil injunctions for consumers against companies for the breach of commitments in codes of conduct. Under the CPRs, the OFT and trading standards procure the right to injunctions. As discussed above, this power has so far not been used widely by the public authorities, however. Consumers would be able to promote CSR much more meaningfully, if they could enforce compliance with CSR commitments through civil injunctions (i.e. stopping companies from making false claims about their compliance with CSR commitments in codes of conduct). The advantage of such a remedy would be that consumers could directly take action against companies for false claims about their CSR record. Due to the publicity that such actions entail, companies could be expected to take CSR commitments more seriously.<sup>1015</sup>

## 5.5 Conclusion

Consumers are increasingly interested in the CSR record of companies. This development is known as ethical consumerism. Many companies have addressed this trend by developing their own CSR policies which they use in their marketing activities to positively influence their image in the perception of consumers. There is an indication that consumers are influenced in their purchase decisions by the CSR commitment of companies. Consumers therefore require protection from false information by companies about their compliance with their CSR commitments. It is against this background that consumer law overlaps with CSR, as it is the object of consumer law to address the inequality of economic power between consumers and

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<sup>1015</sup> An example of a successful complaint (although not brought by consumers themselves) against a company for the publication of misleading information about its CSR record can be found in Germany. The European Centre for Constitutional and Human Rights (ECCHR), together with the Clean Clothes Campaign, initiated a complaint against the retailer LIDL for false claims that the company made about its compliance with social and labor standards in its supplying factories. The complaint was supported by the Customer Protection Agency in Hamburg which, under German law, has standing to bring an action. As a consequence of the complaint, LIDL made a declaration to cease and desist that it would withdraw its claims about its compliance with these CSR commitments. The complaint was based on the German laws of unfair competition (UWG) which implements the Unfair Commercial Practices Directive into German law. The action entailed extensive press coverage. See for an overview of the action: European Centre for Constitutional and Human Rights, ECCHR-Newsletter 09/2010 - Complaint against Lidl, available at: <http://www.ecchr.de> (last accessed: 20/05/2013).

business and to protect consumers. The link between consumer law and CSR is that consumer law prohibits misleading actions by traders. False information by companies about their CSR practices could constitute such misleading actions. Hence, there is potential for consumer law to promote the socially responsible behaviour of corporations.

However, this chapter argues that the way in which consumers are currently protected in private law against false information of companies about their CSR commitments is inadequate. The analysis here has shown that English consumer law currently only promotes CSR to a limited extent. The most obvious way of doing so, the Consumer Protection from Unfair Trading Regulations 2008 (CPRs), are outside the scope of private law as they are only subject to public enforcement by the OFT and local trading standards. Consumers are not able to pursue private redress as they are left without a remedy. This situation is a missed opportunity from a CSR point of view, given that reg 5 (3) (b) CPRs explicitly makes the breach of a commitment in a code of conduct a misleading action, if some further requirements are satisfied. CSR is therefore explicitly brought into the scope of the CPRs. Under the current public enforcement regime of the CPRs the intended beneficiaries of the CPRs, the consumers, are neglected. If consumers are left without a right of action, then it is unlikely that the law will meaningfully promote their position. Consumers are currently in the hands of public institutions.

The law of misrepresentation, as private law, encompasses similar situations to the CPRs and therefore provides protection for consumers, but it is nevertheless a complex area of the law which is difficult to access. The fact that there has so far not been a single case for a misleading action for a breach of CSR commitments in a code of conduct, based on the law of misrepresentation, shows that this law does not sufficiently promote CSR. The recommendation made by the Law Commission in its report from March 2012 to introduce a private remedy as part of a new Act, based on the CPRs, is therefore a step into the right direction. With regard to CSR, the proposals would encompass the same situations as reg 5 (3) (b) CPRs, but with the difference that consumers would have a private remedy to enforce this new Act. The recommendations of the Law Commission contain proposals for appropriate remedies for consumers. The principal right to rescission for consumers would be a powerful tool for the promotion of CSR commitments. In most cases, a rescission will put the consumer into the position he was in before he purchased the good. And, if the consumer has suffered additional loss (something which will probably

only rarely occur in relation to the purchase of goods based on false information about the sellers' CSR record), he would be able to make a claim for damages.

However, there is a danger that the new Act will limit the number of claims brought for breaches of commitments made in codes of conduct. The proposed short definition of misleading actions would exclude the current explicit mentioning of breaches of codes of conduct. This proposal is a reason for concern from a CSR point of view, given that breaches of codes of conduct have so far not been followed up in practice, so consumers are unlikely to be fully aware that such behaviour would continue to fall under the new definition. Moreover, the fact that the new Act would require the formation of a contract in the first place for misleading actions is a further aspect that will reduce the number of potential claims. The sole fact that a company does not meet its CSR commitments in codes of conduct does not suffice for an action in consumer law. It can therefore be concluded that breaches of commitments made in codes of conduct will therefore not constitute misleading actions to the same extent under the new Act as they do under the CPRs. Moreover, consumers would be able to promote CSR much more meaningfully, if they could enforce compliance with CSR commitments through injunctions, irrespective of the formation of a contract.

So, whilst the recommendations of the Law Commission about a new Act would improve the ability of English consumer law to promote the socially responsible conduct of companies, there is a danger that the potential of consumer law will not be fully used due to wording of the definition of 'misleading practices' and due to the requirement to form a contract in the first place. Moreover, a final limiting factor to consider is that, as with the supply contracts analysed in the previous chapter, the particular challenge for the promotion of CSR through consumer law is the conduct of sub-suppliers further down the supply chain. CSR commitments made by companies about the conduct of their sub-suppliers are usually worded in a rather aspirational way which will make it difficult for consumers to follow this conduct up through consumer law.



## Chapter 6: English tort law and Corporate Social Responsibility

### 6.1 The link between tort law and CSR

The conduct of companies can harm people. For instance, employees might be injured due to poor health and safety standards at their workplace or members of the local community in the vicinity of factories might suffer from pollution of the environment. These examples would constitute violations of Corporate Social Responsibility (CSR). It is possible that actions by companies which violate CSR also constitute torts.<sup>1016</sup> CSR and the law of torts overlap where tort law protects the interests that form part of the CSR principles such as the protection of the company's employees, its consumers or the environment.<sup>1017</sup> According to the definition of CSR adopted in this thesis, CSR requires companies to comply with their legal obligations and to pursue objects advancing the interests of all groups affected by their activities, including employees, consumers, suppliers, creditors and local communities.<sup>1018</sup> These interests are not just economic, but also include environmental, human rights and 'quality of life' concerns. It is difficult to find a comprehensive definition of tort law as writers tend not to agree on an all-embracing definition of the law of tort.<sup>1019</sup> The reason is that there are several different forms of torts such as negligence, nuisance, libel, slander, trespass, assault and battery.<sup>1020</sup> Therefore, Giliker and Beckwith suggest defining the law of tort as the law of civil wrongs. Tort law is concerned with behaviour which is legally classified as 'wrong' or

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<sup>1016</sup> J Zerk, *Multinationals and Corporate Social Responsibility* (CUP 2006) 200; A de Jong, *Transnational Corporations and International Law* (Edward Elgar 2011) 94.

<sup>1017</sup> Buhmann points out that, for example, cases in the United Kingdom have demonstrated that the impact of companies on CSR issues such as labour rights, human rights and the environment is of legal relevance with regard to torts, compensation and legal practice. She also mentions that human rights are often considered to be part of CSR. See: K Buhmann, 'Integrating human rights in emerging regulation of corporate social responsibility: the EU case' (2011) 7 (2) *International Journal of Law in Context* 139, 148. The overlap between CSR and human rights and environmental issues also becomes evident in the CSR reports of English corporations which commonly address these issues. See, for example: GlaxoSmithKline, 2011 *Corporate Responsibility Report*, available at: <http://www.gsk.com/content/dam/gsk/globals/documents/pdf/GSK-CR-2011-Report.pdf> (last accessed: 20/10/2012).

<sup>1018</sup> Campbell and Vick define CSR in the following way: 'At a minimum the term implies an obligation on the part of large companies to pursue objectives advancing the interests of all groups affected by their activities – not just shareholders, but also employees, consumers, suppliers, creditors and local communities. These interests are not just economic, but also include environmental, human rights and 'quality of life' concerns. The obligation to be socially responsible is usually conceived of as being over and above the minimum requirement imposed on companies by formal legal rules, although this is not invariably the case.' K Campbell and D Vick, 'Disclosure Law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds.), *The new corporate accountability – Corporate Social Responsibility and the Law* (CUP 2007) 242.

<sup>1019</sup> V Harpwood, *Modern Tort Law* (6<sup>th</sup> edn, Cavendish Publishing 2005) para 1.1.

<sup>1020</sup> P Giliker and S Beckwith, *Tort* (4<sup>th</sup> edn, Sweet & Maxwell 2011) para 1-002.

'tortious' and which entitles the claimant to a remedy.<sup>1021</sup> This chapter will focus on those 'civil wrongs' which could cover violations of CSR, for example the tort of negligence where a company fails to have adequate safety measures in its production site in place resulting in harm to its employees and the local community.

This chapter will analyse to what extent English tort law promotes the socially responsible behaviour of companies. Upon the basis of this analysis, the chapter also seeks to discuss how English tort law could better encourage greater corporate social responsibility. The chapter will first establish the link between tort law and CSR. To that end, a case study of corporate conduct that violates CSR principles will be used in order to analyse if and, if so, how causes of action in tort overlap with CSR principles. This section will also question if tort victims procure an appropriate remedy for violations of CSR. The chapter will then address challenges of using tort law as an instrument for the promotion of CSR, for example, the existence of corporate group structures.

The liability of parent companies in tort to the employees of their subsidiaries has recently become very topical due to the decision in *Chandler v Cape plc*.<sup>1022</sup> In this case it was held that a parent company may be directly liable in negligence to the employees of its subsidiary (to whom it may owe a direct duty of care) irrespective of the separate legal personality of its subsidiary.<sup>1023</sup> The decision is significant in terms of CSR promotion, as the use of corporate group structures poses a hurdle for the liability of parent companies in tort. The chapter will, therefore, discuss the question to what extent *Chandler v Cape plc* establishes principles for the future liability of parent companies in tort to the employees of their subsidiaries

The accountability of corporations for violations of CSR has been on the political and academic agenda for a while.<sup>1024</sup> Due to the protection that tort law offers for personal interests such as health and property, it has been identified as a possible means of promoting CSR. Private individuals could use civil claims based on tort to promote greater social responsibility of corporations. Consequently, there have been some discussions in the literature on CSR and law about the liabilities of companies in tort for the pollution of the environment or the treatment of employees

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<sup>1021</sup> *ibid.*

<sup>1022</sup> [2012] EWCA Civ 525.

<sup>1023</sup> There have been some comments in the literature about the case, see for example: J Fulbrook, 'Chandler v Cape: personal injury: liability: negligence' [2012] *Journal of Personal Injury Law* C135; E McGaughey, 'Donoghue v Salomon in the High Court (Case Comment)' (2011) 4 *Journal of Personal Injury Law* 249.

<sup>1024</sup> For example, the UN gave John Ruggie a six-year mandate as Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business entities.

(particularly, as the protection of human rights is considered to be part of CSR).<sup>1025</sup> However, so far, the debate about corporate liabilities in tort for violations of CSR mainly focusses on transnational tort litigation for torts committed abroad and the liability of parent companies for the conduct of their subsidiaries.<sup>1026</sup> This literature mainly deals with the territorial application of substantive English tort law which is, however, primarily, an issue of private international law and not English private law.<sup>1027</sup> The potentially applicable torts for violations of CSR are often only briefly mentioned.<sup>1028</sup> Hence, the focus of that literature is more on the applicability of English tort law in an international context than on substantive tort law itself. In contrast, this chapter focusses on the use of tort law as an instrument for the promotion of CSR by addressing both the ability of tort law to promote greater socially responsible conduct of companies as well as the challenges of using tort law to that end.

## 6.2 Jurisdictional scope of the chapter

This section will give a brief overview of the jurisdictional scope of the chapter. Questions about the extraterritorial application of English tort law are relevant in a CSR context, as many violations of CSR which involve Western companies (either directly or through their subsidiaries) occur in developing countries. The conduct of multinational companies in developing countries is a matter of concern from a CSR point of view due to reports about human rights abuses in factories in these countries such as the use of child labour and forced labour or the imposition of excessive working hours.<sup>1029</sup> However, the question when English tort law is applicable or should be applicable is primarily a matter of private international law.

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<sup>1025</sup> e.g. J Zerk, *Multinationals and Corporate Social Responsibility* (CUP 2006) 200; A de Jong, *Transnational Corporations and International Law* (Edward Elgar 2011) 94

<sup>1026</sup> e.g. M Anderson, 'Transnational Corporations and Environmental Damage: Is Tort Law the Answer?' (2002) 41 *Wasburn Law Journal* 399.

<sup>1027</sup> A de Jong, *Transnational Corporations and International Law* (Edward Elgar 2011) 91-117; S Baughen, 'Multinationals and the Export of Hazard' (1995) 58 *Modern Law Review* 54; M Anderson, 'Transnational Corporations and Environmental Damage: Is Tort Law the Answer?' (2002) 41 *Wasburn Law Journal* 399; P Muchlinski, 'Corporations in international litigation: problems of jurisdiction and the United Kingdom asbestos cases' (2001) 50 (1) *International Company and Commercial Law Review* 1.

<sup>1028</sup> e.g. A de Jong, *Transnational Corporations and International Law – Accountability in the Global Business Environment* (Edward Elgar 2011) 94.

<sup>1029</sup> see *The Guardian*, 'Apple factories accused of exploiting Chinese workers', 30 April 2011, available at: <http://www.guardian.co.uk/technology/2011/apr/30/apple-chinese-factory-workers-suicides-humiliation?INTCMP=SRCH>; *The Independent*, 'Leading article: The gruesome reality of sweatshops', 1 October 2010, available at: <http://www.independent.co.uk/opinion/leading-articles/leading-article-the-gruesome-reality-of-sweatshops-2094318.html?origin=internalSearch> (last accessed: 21/04/2013); R Locke et al., 'Beyond corporate codes of conduct: Work organization and labour standards at NIKE's suppliers' (2007) 146 (1-2) *International Labour Review* 21, 21.

Apart from the overview in this section, it will therefore not be addressed in detail in this chapter.<sup>1030</sup>

The first issue is when English courts have jurisdiction to hear the merits of the dispute. It is likely that tort victims will bring an action for tort at English courts even where the tort was committed abroad. English courts will be a popular choice due to their independence as well as the reputational damage that a proceeding in England entails for the English company that is sued. The court must apply the Brussels I Regulation in order to determine whether it can assume jurisdiction.<sup>1031</sup> Pursuant to Article 2 (1) of the Brussels I Regulation No 44/2001 on jurisdiction and recognition of enforcement of judgments in civil and commercial matters ('Brussels I Regulation'), persons domiciled in a member state shall, whatever their nationality, be sued in the courts of that member state. This rule means that English companies could be sued for their own conduct or the conduct of their subsidiaries in other countries before English courts.<sup>1032</sup>

It is a different question, however, if English tort law is applicable where the tort was committed abroad. Generally, the law applicable to non-contractual obligations is determined by the Rome II Regulation.<sup>1033</sup> Pursuant to Article 4 (1) of the Regulation, the law applicable to a non-contractual obligation arising out of a tort/delict shall be the law of the country in which the damage occurs, irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur. The place where the damage occurs is 'narrowly circumscribed'.<sup>1034</sup> This means that, when the tort is committed outside England and Wales, the liability is usually

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<sup>1030</sup> Due to the focus of this thesis on substantive English private law, it would be beyond its scope to comprehensively analyse and discuss the question under what circumstances English tort law is (or should be) applicable to torts that occur outside England and Wales. This question merits further discussion in subsequent research. The issue of extraterritorial legislation and corporate liability is discussed, for example, in A de Jonge, *Transnational Corporations and International Law – Accountability in the Global Business Environment* (Edward Elgar 2011) 91–126.

<sup>1031</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters" (or Council Regulation (EC) 44/2001).

<sup>1032</sup> The common law doctrine of *forum non conveniens* had for long established a hurdle for claims against companies for torts committed abroad, either directly or by their subsidiaries. The doctrine enables courts to deny jurisdiction if there is another more appropriate forum where the course may be heard. See: A de Jonge, *Transnational Corporations and International Law* (Edward Elgar 2011) 108. It has been argued that the ECJ decision in *Owusu v Jackson and Ors* (Case C-281/02 (2005) 2 WLR 942) has effectively put an end to the application of *forum non conveniens* by English courts. In its interpretation of the Brussels Regulation, the ECJ decided that it was inconsistent with the Brussels Regulation to apply the *forum non conveniens* doctrine to grant a stay in favour of another jurisdiction of a non-contracting state if the defendant is domiciled in a member state. But note that the applicable law may still be the law of the country where the tort occurred.

<sup>1033</sup> 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 (Rome II). This regulation is effective since January 2009. It has, by and large, replaced the Private International Law (Miscellaneous Provisions) Act 1995.

<sup>1034</sup> C Clarkson and J Hill, *The Conflicts of Law* (4<sup>th</sup> edn, OUP 2011) 265.



determined by the foreign law of the place where the tort occurred, although there are some exceptions, for instance, for environmental damage<sup>1035</sup>.<sup>1036</sup>

### 6.3 Causes of action in tort law for violations of CSR

This section will analyse if and, if so, how causes of action in tort contribute to the promotion of CSR in English private law. The previous chapters on contract law and consumer law referred to examples of bribery, environmental pollution and CSR violations that occur in the employment context (use of forced and child labour, access to trade unions, working hours). This chapter will use a hypothetical case study of a company that has emitted toxic gases that resulted in harm to some of its employees, the local community and environmental pollution. The reason for using this case study is that it covers the same groups affected by corporate conduct as in the previous example, i.e. harm suffered by employees and the environment, whilst avoiding the need to analyse in detail the different issues of bribery, environmental pollution and the use of forced and child labour from a tort perspective. These scenarios would raise very different actions in tort and therefore go beyond the scope of this chapter. The one case study here will be used as an example for the promotion of CSR in tort.<sup>1037</sup> At first sight, there is a strong overlap between CSR and several causes of action in tort, as torts protect personal interests such as health and property that are often violated where companies act in an irresponsible way. Health and property are protected by the torts of negligence, breach of a statutory duty, private and public nuisance. Moreover, other causes of action in tort provide redress for interference with the person. These are the torts of trespass to the person, i.e. battery, assault and false imprisonment.<sup>1038</sup> Examples often referred to in the CSR literature where these torts can be applicable are the use of forced labour and child labour as well as corporal punishment at the workplace.

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<sup>1035</sup> Article 7 of the Regulation.

<sup>1036</sup> There are exceptions to this general rule, but it would be beyond the scope of this chapter to address these. An example of such an exception is that English law will be applicable where both the tortfeasor and the tort victim have their habitual residence in England or Wales at the time when the damage occurred (Article 4 para 2 Rome II).

<sup>1037</sup> Moreover, the interest of the employees and the environment are explicitly mentioned in the definition of CSR adopted for this thesis. See note 3 above for the definition. According to that definition, the concept of CSR requires companies to pursue objects which advance the interests of employees, the local community, the environment and consumers amongst others.

<sup>1038</sup> The tort of assault covers an intentional act that threatens violence. The tort of battery consists of an intentional, direct act of the defendant resulting in an undesired contact with the person of the claimant. The tort of false imprisonment consists of the complete restriction of the claimant's freedom of movement without lawful excuse or justification. See for an overview of these torts: S Deakin, A Johnston and B Markesinis, *Markesinis and Deakin's Tort Law* (6<sup>th</sup> edn, OUP 2008) 451 – 467.

As companies are an artificial legal entity, they can only commit torts through the acts of their employees or agents.<sup>1039</sup> Companies are liable in tort through vicarious liability which is not a tort in its own right, but a rule of responsibility.<sup>1040</sup> Vicarious liability denotes the liability of a company for actions of other people.<sup>1041</sup> Companies can commit torts through vicarious liability for the wrongful acts of an employee or agent acting during the course of his employment or scope of his authority.<sup>1042</sup> Company directors fall under either or both of these categories, so a company can be vicariously liable for their torts.<sup>1043</sup> Vicarious liability does not mean that the tortfeasor (e.g. company director) is exempt from his personal liability, but it provides the tort victim with a choice as to whom he sues.<sup>1044</sup> In such a situation the defendant will often be the employer (the company), as he usually has better financial means than the employee who committed the tort.<sup>1045</sup>

### 6.3.1 Case study on the promotion of CSR in tort law

As indicated, the analysis of the promotion of CSR in tort law will be based on a fictitious case. The scenario used here concerns a company that has breached health and safety standards and has consequently emitted toxic gases from its

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<sup>1039</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 3-64.

<sup>1040</sup> P Giliker and S Beckwith, *Tort* (4<sup>th</sup> edn, Sweet & Maxwell 2011) para 7-022.

<sup>1041</sup> D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-12) para 19.7.2.

<sup>1042</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 3-64.

<sup>1043</sup> P Davies and S Worthington, *Gower and Davies' Principles of Modern Company Law* (9<sup>th</sup> edn, Sweet & Maxwell 2012) para 7-39. See for a discussion of the personal liability of a company director for torts which he committed: B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 3-67 to 3-81. The decision in *Standard Chartered Bank v Pakistan National Shipping Corp* [2003] 1 BCLC 244 has established that a director can be personally liable in tort. The fact that he is a director does not bar his personal liability. A director is not automatically an employee by being appointed to a directorship, but it is possible that directors also have a service contract and are considered to be employees. See for a discussion about the employment status of directors: D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-12) para 15.9.1.5. In any case, they will be agents of the company. The vicarious liability of a company for the acts of its employees or agents must be distinguished from the question if a company is also vicariously liable for the acts of third parties, particularly its subsidiaries which is discussed below.

<sup>1044</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 3-64.

<sup>1045</sup> V Harpwood, *Modern Tort Law* (6<sup>th</sup> edn, Cavendish Publishing 2005) para 16.1. In order to establish vicarious liability three conditions must be met: First, the employee must have committed a tort, secondly, there must be an employer/employee relationship and thirdly, when committing the tort, the employee must have acted in the course of his employment. Employers are generally not vicariously liable for the actions of independent contractors. However, as the nature of many employment relationships have changed in recent years, courts had to address a range of questions in deciding if a contract is one of employment or for services. When making that distinction, courts look at the relationship as a whole. See: P Giliker and S Beckwith, *Tort* (4<sup>th</sup> edn, Sweet & Maxwell 2011) para 7-027. An employee is considered to be acting in the course of employment if his conduct is authorised by the employer, or is considered to be an authorised means of performing the job for which he is employed. The latter category has been interpreted as covering actions which are closely connected to the job for which the tortfeasor is employed. Importantly, if an employee engages in activities which his employer has expressly prohibited, then this does not mean that he has acted outside the course of his employment. Companies can therefore not avoid vicarious liability for the conduct of their employees by prohibiting certain activities. An employee relationship is created where there is a contract of service rather than a contract for service. See: P Giliker and S Beckwith, *Tort* (4<sup>th</sup> edn, Sweet & Maxwell 2011) para 7-030.

factory. This emission of gases has injured some employees at the production site, and they have been subsequently been hospitalised. The toxic gases have also caused injury to the health and property (e.g. plants in the garden) of the local community. Moreover, the emission has generally resulted in pollution of the local environment. The emission of toxic gases due to a breach of health and safety standards is an example of irresponsible corporate conduct and therefore a suitable example of a breach of CSR principles.

Insofar as the employment context is concerned, it is necessary to distinguish between claims of an employee based on tort and in contract, as there is a contractual relationship between employers and their employees through the employment contract. Employment contracts contain terms which impose duties upon the employers and the employees.<sup>1046</sup> Moreover, there are also tortious duties imposed on employers, primarily in statutes and through the general duty of care in negligence. When an employee is injured at the workplace, then his employer faces concurrent liability in contract and in tort.<sup>1047</sup> In *Hagen v ICI Chemicals and Polymers Ltd*<sup>1048</sup> and in *Lennon v Metropolitan Police Commissioner*<sup>1049</sup>, it was held that employees are entitled to sue in contract and in tort at common law.<sup>1050</sup> The claimant can therefore decide whether to sue in contract or in tort.<sup>1051</sup> Whilst the decision of a claimant whether to sue in contract or tort will be influenced by the individual circumstances, this section analyses the liability of employers to their employees in tort law due to the focus of the chapter on tort law.<sup>1052</sup>

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<sup>1046</sup> As far as the employer is concerned, there are several implied terms in employment contracts in common law which require him, inter alia, to have due regard for the health and safety of his employees, e.g. to take reasonable care to ensure the health and safety of the employees, see: *Johnstone v Bloomsbury AHA* [1991] 2 All ER 293. The implied terms concerning the duties of the employer for the health and safety of his employees cannot be overridden by express terms due to the requirements of the Unfair Contract Terms Act. If these duties are breached, then an employee could bring a claim for breach of contract, see: S Taylor and A Emir, *Employment Law: An Introduction* (OUP 2006) 382.

<sup>1047</sup> Employees who suffer from an industrial accident are also entitled to claim benefits from the Department for Work and Pensions.

<sup>1048</sup> [2002] IRLR 31.

<sup>1049</sup> [2004] 2 All ER 266.

<sup>1050</sup> Employers therefore face concurrent liability, particularly in relation to employers' liability for physical injury. See: M Boyle, 'Employers' liability at common law: two competing paradigms' (2008) 12 *Edinburgh Law Review* 231, 236.

<sup>1051</sup> *Matthews v Kuwait Bechtel Corporation* [1959] 2 QB 57, 67.

<sup>1052</sup> In English tort law, it is more common for employees to base their claims against their employers for injuries resulting from a breach of health and safety standards on tort. It is nevertheless important to know that breaches of health and safety regulations can also constitute breaches of implied terms of a contract of employment. See for a discussion about the reasons for claimants to choose either tort or contract as the base for their claim: S Taylor and A Emir, *Employment Law: An Introduction* (OUP 2006) 382–383. Generally, employers are popular targets for tort claims as they are required to have insurance, see Employers' Liability (Compulsory Insurance) Act 1969.

### 6.3.1.1 The tort of negligence

In this case study, the interests of the company's employees and the local community can particularly be protected through the torts of negligence, breach of a statutory duty as well as private nuisance and public nuisance.<sup>1053</sup> This section will only apply the example of the tort of negligence to the case study.<sup>1054</sup> This choice is based on three main reasons. First, the tort of negligence provides compensation for harm to the interests affected in the case study here (i.e. the health of the employees as well as the health and the proprietary interests of the local community).<sup>1055</sup> Secondly, the tort of negligence is the most widely used tort.<sup>1056</sup> Thirdly, although the torts of breach of a statutory duty, private nuisance and public nuisance could also be used in this scenario, their scope overlaps with negligence in terms of the interest of the claimants affected here.<sup>1057</sup> An analysis of these torts, too, is therefore not necessary for the purpose of this chapter. Instead of providing an exhaustive study of all torts that are potentially relevant here, this chapter rather aims to examine the strengths and limitations of tort law in the promotion of CSR based on the example of the tort of negligence. Where necessary, differences between the tort of negligence and other torts will be pointed out.

In short, the main conditions of claims in negligence are the following: First, there must be a duty of care which is owed by the defendant to the claimant; secondly, the defendant must have been in breach of his duty; and thirdly, there must have been a sufficient causal link between the tort and the harm the claimant has suffered.<sup>1058</sup> Fourthly, there must be damage.<sup>1059</sup> The tort of negligence, based on a breach of a duty of care owed by the defendant to the claimant, was established in *Donoghue v Stevenson*.<sup>1060</sup> Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of

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<sup>1053</sup> See for an introduction to private nuisance and public nuisance in the context of environmental torts: S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5th edn, Routledge 2011) 510–527.

<sup>1054</sup> Even though in practice many tortious claims in the employment context are based on the breach of a statutory duty rather than on the tort of negligence, it is still possible to pursue a claim for breach of a duty of care in negligence as residual cause of action if there is no liability for breach of a statutory duty, see: *Thames Trains v Health and Safety Executive* [2002] EWHC Civ 1415.

<sup>1055</sup> V Harpwood, *Modern Tort Law* (6<sup>th</sup> edn, Cavendish Publishing 2005) para 19.1.

<sup>1056</sup> The vast majority of tort claims are for negligence, see: V Harpwood, *Modern Tort Law* (6<sup>th</sup> edn, Cavendish Publishing, London 2005) para 1.6; S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5th edn, Routledge 2011) 527.

<sup>1057</sup> Injured employees often sue their employers both for negligence and breach of a statutory duty at the same time, as they have a higher chance of winning their case this way, see: S Taylor and A Emir, *Employment Law: An Introduction* (OUP 2006) 390.

<sup>1058</sup> V Harpwood, *Modern Tort Law* (6<sup>th</sup> edn, Cavendish Publishing, London 2005) para 2.3.1.

<sup>1059</sup> S Deakin, A Johnston and B Markesinis, *Markesinis and Deakin's Tort Law* (6<sup>th</sup> edn, OUP 2008) 113.

<sup>1060</sup> [1932] AC 562.

human affairs, would do, or doing something harmful which a prudent and reasonable man would not do.<sup>1061</sup>

In terms of the first condition, a duty of care exists either where the action in question is covered by precedent or, otherwise, following the decision in *Caparo v Dickman*<sup>1062</sup>, where the following factors can be established: foresight, proximity and justice.<sup>1063</sup> These three factors mean that the type of harm in question must have been reasonably foreseeable to the tortfeasor, that a relationship of proximity exists between the parties (such a relationship, can, for instance, be based on a professional relationship as in an employment situation) and that it must be fair, just and reasonable that the law imposes a duty of care upon a party for the benefit of the other (this criterion encompasses a broad range of considerations such as public policy implications, e.g. human rights issues). In the case on which the analysis in this section is based, it can be argued that harm to both the employees and the local community resulting from the emission of toxic gases is reasonably foreseeable for companies which use toxic gases in the manufacturing process and which breach health and safety standards. Proximity can be established here, for example, based on the employment relationship or the vicinity of the neighbours to the factory. Finally, fairness concerns justice between the parties and the legal system as a whole. The imposition of a duty of care on the company in the example here is fair, just and equitable due to the potential danger that toxic gases can pose to the employees and the community. Where a company keeps toxic gases, it must carefully follow safety standards. The consideration of public policy in this context overlaps with CSR, as the socially responsible conduct of companies is in the public interest. It is likely that CSR will increasingly influence the public policy implications in this respect to the extent that the concept gains importance in the public debate about the role of business in society. Therefore, a duty of care owed by the company to the employees and the local community not to expose these to toxic gases can be established here.

Secondly, the claimant will only be successful in his claim, if the defendant has breached his duty of care. The test that is, traditionally, applied in this respect is the 'reasonable man' test.<sup>1064</sup> This test is, as far as possible, objective.<sup>1065</sup> Different versions of this test have been developed by judges over the years. For instance, in

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<sup>1061</sup> *Blythe v Birmingham Waterworks Co* (1856) 11 Exch 781.

<sup>1062</sup> [1990] 2 A.C. 605.

<sup>1063</sup> P Giliker and S Beckwith, *Tort* (4th edn, Sweet & Maxwell 2011) para 2-015.

<sup>1064</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 7.1.

<sup>1065</sup> *ibid.*

*Blythe v Birmingham Waterworks*<sup>1066</sup> it was held that ‘negligence is the omission to do something harmful which a reasonable man, guided upon those considerations which ordinarily regulate human affairs, would do, or doing something which a prudent and reasonable man would not do.’ Where a profession is concerned, the standard expected would take into account the standards that are deemed reasonable for that profession.<sup>1067</sup> In the example here, the company whose factory has emitted toxic gases was in breach of health and safety requirements, so its behaviour has clearly fallen below that to be objectively expected from the company in the running of its manufacturing process. A duty of care has therefore been breached in the example. Generally, the ‘reasonable man’ test overlaps with CSR principles, as irresponsible conduct by companies, for example in case of environmental pollution or the breach of the human rights of employees, is likely to fall below the objective standard of behaviour required from companies.

Thirdly, the people who suffered from the exposure to toxic gases must establish a sufficient causal link between the negligent act and the harm suffered. The claimants must therefore prove that the negligent act of the defendant caused or materially contributed to the damage complained of.<sup>1068</sup> The relationship between the act and the damage is usually established by the ‘but for’ test, i.e. the test is satisfied when the harm would not have occurred ‘but for’ the defendant’s act.<sup>1069</sup> The establishment of causation can be difficult where the defendant can argue that further factors could have caused the harm of the claimant. In the example here, it is therefore necessary to prove the link between the injuries suffered by the company’s employees as well as the members of the local community and the emission of toxic gases. The action will fail where the court finds that the likelihood that the injury would have occurred without the defendant’s negligence is higher than 50%.<sup>1070</sup> The focus is therefore on the balance of probabilities. In a case that concerns the exposure to asbestos, *Fairchild v Glenhaven Funeral Services Ltd*<sup>1071</sup>, the House of Lords accepted the causal link where only an increased risk of an injury could be proven vis-à-vis the defendant.<sup>1072</sup> For the negligence actions of the employees and

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<sup>1066</sup> (1865) 11 Ex 781.

<sup>1067</sup> see *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582.

<sup>1068</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 8.2.

<sup>1069</sup> *Barnett v Chelsea and Kensington Hospital Management Committee* [1969] 1 QB 428.

<sup>1070</sup> See for further discussion: S Deakin, A Johnston and B Markesinis, *Markesinis and Deakin’s Tort Law* (6<sup>th</sup> edn, OUP 2008) 249.

<sup>1071</sup> [2002] UKHL 22.

<sup>1072</sup> The case concerned claims brought against the defendant by victims of mesothelioma. This fatal disease can be contracted by inhaling asbestos. In this case, the claimants were exposed to asbestos by a number of employers. It could therefore not be established which particular exposure caused the mesothelioma. This disease can be caused by the inhaling of one particular particle of dust. In contrast, other forms of illnesses caused by exposure to asbestos are cumulative diseases which means that each separate employer can be held liable for a proportion of the disease.

members of the local community to succeed it is therefore necessary to prove the causal link between the injury and the breach of duty, i.e. the emission of toxic gases. Where the injuries are suffered immediately, it is probable that this causal link can be established.

Fourthly, the damage that the claimant suffered must not be remote. Remoteness can be established where an intervening act breaks the 'chain of causation'.<sup>1073</sup> The test applied is if the way the harm occurred was reasonably foreseeable.<sup>1074</sup> In the situation here, the damage to health caused by those exposed to the toxic gases that emitted from the company's factory is foreseeable.

Finally, the claimants must have suffered harm due to the negligent act of the tortfeasor. Here, the employees and the members of the local community have sustained damage to their health and property. Both physical (bodily) harm and damage to property are covered by the tort of negligence.<sup>1075</sup>

In conclusion, the tort of negligence provides a possible cause of action in tort for both the employees and the members of the public who have suffered injuries to their health and property, following the exposure to toxic gases that were emitted by the company in breach of health and safety requirements.

### **6.3.1.2 Remedies**

In order to meaningfully promote the socially responsible conduct of companies, tort law would also need to provide the claimants with an appropriate remedy. In principle, the remedies which are relevant for the claimant are damages and injunctions.

The tort victims in this case study have all suffered damages to their health and/or property as a result of the tort committed by the company. Tort victims primarily seek compensation for their injuries resulting from the wrongful act.<sup>1076</sup> The aim of the award of damages is to put the claimant into the position in which he would have been had the harm or damage not occurred.<sup>1077</sup> There are different kinds of damages which are awarded for torts. Most damages are of a compensatory nature

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<sup>1073</sup> See S Deakin, A Johnston and B Markesinis, *Markesinis and Deakin's Tort Law* (6<sup>th</sup> edn, OUP 2008) 266.

<sup>1074</sup> *ibid*, 271.

<sup>1075</sup> *ibid*, 138.

<sup>1076</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 19.1.

<sup>1077</sup> S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5th edn, Routledge 2011) para 11.3.1.

which means that the aim is to compensate the claimant for loss he has suffered.<sup>1078</sup> Damages which can be calculated exactly are called special damages; if the amount of damages cannot be assessed exactly, then they are called general damages.<sup>1079</sup> If tort victims have sustained personal injury, then they are able to receive damages in compensation for pain and suffering and loss of amenities of life.<sup>1080</sup> They will also be able to recover in damages the loss of earnings and the medical expenses which they incur as a consequence of the physical harm.<sup>1081</sup>

Courts may also award punitive or exemplary damages for torts.<sup>1082</sup> If exemplary damages are awarded, then the courts award additional damages on top of the compensatory damages in order to punish the wrongdoer and also in order to deter others from committing similar acts. However, exemplary damages are only awarded in rare circumstances, as established in *Rookes v Barnard*<sup>1083</sup>: First, where servants of the government act in an oppressive, arbitrary or unconstitutional way; secondly, where the defendant's conduct was intended to profit from the tort; thirdly, where a statute forming the basis of the tortious act expressly permits the payment of exemplary damages. In the case study underlying this chapter the only potentially relevant category is where the defendant intended to profit from the tort. This situation might be possible in cases of environmental pollution where a company decides to go ahead with its production which pollutes the environment in order to raise its profits, having calculated that the profits resulting from the act will be higher than the potential compensation payable in tort. The reason why exemplary damages are only awarded very rarely in English law is that the main object of damages is to put the claimant into the position in which he would have been had the tort not occurred. The main argument against the award of exemplary damages is that they would confuse the objects of the civil side (to compensate) and the criminal side (to punish) of law; however, the Law Commission argued that civil punishment, if put on a principled basis, would serve an important function.<sup>1084</sup> Exemplary damages are available at the moment, but they are very limited in use.

As with most tort victims, the people suffering from the tort in the case study underlying this chapter will primarily seek compensation for the injuries that they have sustained. Tort law is able to put these people back into their original position

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<sup>1078</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 19.2.2.

<sup>1079</sup> *ibid.*

<sup>1080</sup> P Giliker and S Beckwith, *Tort* (4th edn, Sweet & Maxwell 2011) para 17-004.

<sup>1081</sup> *ibid.*, para 17-018.

<sup>1082</sup> *ibid.*, para 19.2.5.

<sup>1083</sup> [1964] AC 1129.

<sup>1084</sup> Law Commission, *Aggravated, Exemplary and Restitutionary Damages*, (no 247, 1997), [http://lawcommission.justice.gov.uk/docs/lc247\\_aggravated\\_exemplary\\_and\\_restitutionary\\_damages.pdf](http://lawcommission.justice.gov.uk/docs/lc247_aggravated_exemplary_and_restitutionary_damages.pdf) (last accessed: 21/11/2012).



through the award of damages. They will all be compensated in tort for the harm that they have suffered to their health and property. Damages offer a strong attraction to the injured party as they compensate financially for the injury sustained.<sup>1085</sup> Therefore, tort law fulfils an important object of claims, namely compensation for the injury. In that respect, damages are an appropriate remedy for people who have suffered from a tort which also constitutes a violation of CSR. It is unlikely though that the claimants will also obtain exemplary damages.

Tort victims can also seek to be granted an injunction against the tortfeasor to prevent him from committing the tort again.<sup>1086</sup> Injunctions could be an appropriate remedy in the case studies analysed in this chapter. The employees and the local community have an interest not to be exposed to hazardous substances again resulting from further health and safety breaches in the future. However, the availability of injunctions is limited. Injunctions are an equitable remedy which is subject to the court's discretion even if the claimant proves the case.<sup>1087</sup> This remedy cannot be requested as of right.<sup>1088</sup> Injunctions will not be awarded where damages are not appropriate or where it would not be equitable to award them.<sup>1089</sup> The general rule is that, pursuant to s50 of the Senior Courts Act 1981, courts may award damages in addition to, or in substitution for, an injunction or specific performance. Injunctions can be divided into mandatory injunctions which enable the court to order the defendant to undo or remedy the damage or prevent further damage from occurring and prohibitory injunctions which order the defendant not to continue with the wrongful act.<sup>1090</sup> Injunctions are more likely to be awarded for the tort of private nuisance than in response to other torts. This remedy will only be refused where the nuisance is trivial.<sup>1091</sup> The claimants in the case study would therefore probably need to bring an action in nuisance, if they were to be granted the remedy of injunction. However, in principle, it will be difficult for them to receive an injunction as it is an equitable remedy.

#### **6.4 The contribution of tort law to the promotion of CSR**

With its protection of individual interests such as the health and property of the employees and the local community in the case study here, the tort of negligence

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<sup>1085</sup> M Anderson, 'Transnational Corporations and Environmental Damage: Is Tort Law the Answer?' (2002) 41 *Washburn Law Journal* 399, 408.

<sup>1086</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 1.1 and para 19.12.

<sup>1087</sup> *ibid.*

<sup>1088</sup> P Giliker and S Beckwith, *Tort* (4<sup>th</sup> edn, Sweet & Maxwell 2011) para 17-059.

<sup>1089</sup> *ibid.*

<sup>1090</sup> S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5<sup>th</sup> edn, Routledge 2011) para 11.3.2.

<sup>1091</sup> *ibid.*

overlaps with CSR. Generally, the interests that causes of action in tort protect largely overlap with the interests that CSR aims to enhance, e.g. the protection of private individuals from battery, assault, false imprisonment and indeed other causes of harm to their health and/or property. Tort law therefore provides several groups of people, who are, by definition, encompassed by CSR, with a remedy in tort for violation of their interests. Through the provision of remedies, tort law is a means of enforcing CSR principles. Moreover, as tort law develops incrementally, it can be influenced by CSR. If the idea of CSR gains wider public acceptance, for instance, resulting from the UK government's endorsement of the UN Guiding Principles on Business and Human Rights, then it is possible that the criterion 'just, fair and equitable' for the imposition of a duty of care, as well as the standard applied to breaches of duty of care, would be further influenced by CSR considerations. The idea of socially responsible conduct of companies could have an impact on the general perception of what duties of care a company has and when it breaches these duties. Finally, the overlap between tort law and CSR provides arguments against those who argue that CSR was a purely voluntary concept. This case study has further shown that CSR is, at least in part, law.

Tort law therefore already makes an important contribution to the promotion of CSR in a number of ways.

Nevertheless, tort law has a number of weaknesses in its ability to promote the socially responsible conduct of companies. First of all, where actions are brought in tort (e.g. negligence), the limitation is the two-party relationship between the claimant and the defendant. The action in tort will only resolve the dispute between these two parties, but not comprehensively for the society as a whole.<sup>1092</sup> Although the dispute might encompass CSR principles and, consequently, have a wider impact on society by making a company liable for violations of CSR, the limitation of using tort law for promoting CSR is, nevertheless, the case-by-case development which depends on private parties bringing a case to court. Tort law only develops incrementally. In contrast, public law regulation, for example about the environment, could comprehensively impose and enforce duties on companies in an area of law. In private law, CSR issues such as the protection of the environment are not necessarily comprehensively regulated in such a way.<sup>1093</sup>

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<sup>1092</sup> The issue of multiparty (i.e. class actions) access to tort litigation will be further developed in the section on 'Access to civil litigation'.

<sup>1093</sup> For instance, it is argued that the 'fragmented, case-by-case' development of environmental tort would 'undermine the rationality of a consistent legal framework', see: M Anderson, 'Transnational

Secondly, although the case study only looked at the tort of negligence it nevertheless showed obstacles that a claimant in torts needs to overcome in the promotion of CSR. Generally, in civil claims the claimant must prove the conditions of his claim which can be difficult, for example, in environmental torts it may be difficult to prove that the damage was caused by the defendant (e.g. by the defendant's emission of gases).<sup>1094</sup> Other reasons may have caused the damage, too. Thirdly, as torts are based on damage to personal interests, only parties with such interests can bring an action.<sup>1095</sup> Tort actions are, by and large, aimed at protecting private interests.<sup>1096</sup> On the contrary, there is no action in tort for the pollution of the environment per se.<sup>1097</sup> The environment is only protected by tort law to the extent that the tort has violated private interests. The environment does not gain standing itself and will not be covered per se in the damages payable. The remedy will be granted to the claimant and, therefore, not to the environment. Consequently, in the case study used in this chapter the environmental pollution will only be remedied by the action in tort to the extent that personal property (e.g. land) of claimants was harmed, but not to the extent that the environment was generally polluted. There is no remedy that requires the companies which pollute the environment to fully remedy the negative impact their actions had on the environment generally, other than the damage to personal property. Tort law is therefore restricted in its ability to protect the environment. Fourthly, tort law is only a reactive tool that is brought after the tort has occurred in the first place, although it is acknowledged that the danger of having to pay damages in tort might also act as deterrent.<sup>1098</sup>

Finally, the remedies provided in tort for violations of CSR are also limited in their ability to promote the socially responsible conduct of companies. Due to their compensatory nature, damages for violations of CSR will only be awarded where the claimant has suffered a health injury or damage to property in the first place. The claim is therefore reactive rather than preventive although it is acknowledged that the remedy of damages provides deterrence for potential tortfeasors.<sup>1099</sup> The award

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Corporations and Environmental Damage: Is Tort Law the Answer?' (2001-2002) 41 *Washburn Law Journal* 399, 409.

<sup>1094</sup> S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5th edn, Routledge 2011) 505.

<sup>1095</sup> See for a discussion of private law actions being based on private interests: D Howarth, 'Muddying the Waters: Tort Law and the Environment from an English Perspective' (2001-2002) 41 *Washburn Law Journal* 469, 472.

<sup>1096</sup> P Cane, 'Using Tort Law to Enforce Environmental Regulations?' (2001-2002) 41 *Washburn Law Journal* 427, 443.

<sup>1097</sup> S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5th edn, Routledge 2011) 505.

<sup>1098</sup> A Kanner, 'Toxic Tort Litigation in a Regulatory World' (2001-2002) 41 *Washburn Law Journal* 535, 542.

<sup>1099</sup> See for a discussion about the deterrence function of tort law: S Deakin, A Johnston and B Markesinis, *Markesinis and Deakin's Tort Law* (6<sup>th</sup> edn, OUP 2008) 50 – 52.

of exemplary damages could be a particular deterrent for companies not to engage with irresponsible activities. Whilst the primary aim of tort is to compensate the tort victim for the harm suffered, the promotion of CSR through tort law could be enhanced if companies were more frequently to face the payment of exemplary damages for particularly irresponsible acts such as environmental pollution. Similarly, whilst it is acknowledged that the payment of compensation is often of particular importance for the claimant who has usually suffered a loss, the criticism can be made from a CSR point of view that injunctions are difficult to obtain. As injunctions are an order on the defendant not to continue with a certain act or to undo the damage, they would be particularly useful for violations of CSR. For example, an injunction to stop an act that causes environmental pollution would serve the needs of the local community that suffers from the pollution as well as better protect the interests of the environment. The injunction could be granted in addition to damages. Injunctions are therefore a potentially powerful tool in response to violations of CSR as they directly affect the behaviour of the tortfeasor.<sup>1100</sup> For tort law to be a more effective means of promoting CSR, it would be necessary to further develop and expand the use of injunctions as a remedy, although this remedy is an equitable remedy which is at the discretion of the courts.

It can therefore be concluded that despite the undeniable overlap between causes of action in tort and CSR, tort law is restricted in a number of ways in its ability to promote greater socially responsible conduct of companies. But despite its limitations, tort law already makes an important contribution to the promotion of CSR and it could make an even better contribution if some of its weaknesses (e.g. the limited use of injunctions) were addressed.

## **6.5 The challenge of using tort law as a means to promote CSR**

The particular challenge for using tort law as an instrument to promote greater CSR is often not tort law itself, but rather the access to using tort law against companies. The following section will therefore look at challenges for tort victims who want to use tort law against companies.

### **6.5.1 The use of corporate group structures**

The promotion of CSR in tort faces a particular challenge through the use of corporate group structures. Many companies create sophisticated group structures

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<sup>1100</sup> See for a discussion of the suitability of injunctions in case of environmental torts: S Wolf and N Stanley, *Wolf and Stanley on Environmental Law* (5<sup>th</sup> edn, Routledge 2011) 507.

consisting of a parent company with several subsidiaries.<sup>1101</sup> As the subsidiaries are, in law, separate entities, the parent company is not responsible for their liabilities, unless the corporate veil is pierced which happens only rarely.<sup>1102</sup> Group structures therefore enable parent companies to reduce their liability risk in tort.<sup>1103</sup> Consequently, tort victims of a subsidiary company (e.g. the local community suffering from the emission of hazardous substances) might not be able to recover the loss from the subsidiary, particularly as, in practice, the parent company is often in a better financial position to compensate tort victims than some of its (undercapitalised) subsidiaries.<sup>1104</sup> So, if an undercapitalised subsidiary is unable to cover the loss of a tort victim, the tort victim (as an involuntary creditor<sup>1105</sup>) faces the danger of being left with nothing.<sup>1106</sup>

The following section will therefore review to what extent parent companies are liable in tort for violations of CSR principles by their subsidiaries, either directly or vicariously.<sup>1107</sup>

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<sup>1101</sup> See J Birds et al. (eds.) *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 3.9. The Companies Act 2006 defines subsidiary and holding company in s1159. S1159 (1) CA: A company is a 'subsidiary of another company, its 'holding company', if that other company – (a) holds a majority of the voting rights in it, or (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or if it is a subsidiary of a company that is itself a subsidiary of that other company. S1159 (2): A company is a 'wholly-owned subsidiary' of another company if it has no members except that other and that other's wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries.'

<sup>1102</sup> The piercing of the corporate veil is discussed below.

<sup>1103</sup> B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) para 3-44.

<sup>1104</sup> See P Muchlinski, 'Holding multinationals to account: recent developments in English litigation and the Company Law Review' (2002) 23 *Company Lawyer* 168. See for discussion of this issue also: J Birds et al. (eds.) *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordans 2011) para 3.10.2.

<sup>1105</sup> Tort victims are often referred to as involuntary creditors: P Muchlinski, 'Limited liability and multinational enterprises: a case for reform?' (2010) 34 *Cambridge Journal of Economics* 915, 918.

<sup>1106</sup> See for an overview of the discussion pertaining to the consequence of limited liability for involuntary tort creditors: S Lo, 'Liability of directors as joint tortfeasors' (2009) 2 *Journal of Business Law* 109, 120.

<sup>1107</sup> The use of subsidiary companies is also a challenge for the promotion of CSR through the other areas of private law analysed in this thesis such as contract law and consumer law. This situation was recognised in the respective chapters. The privity of contract doctrine restricts the reach of contract law beyond the parties to the contract. However, some companies publicly declare that they aim to promote the application of their corporate responsibility principles throughout their whole supply chain (e.g. Vodafone declares in its business code that it seeks 'to promote the application of our Business Principles by our business partners and suppliers'). In consumer law, the liability of a parent company for the conduct of its subsidiaries depends on the question whether the parent company has made public commitments about the socially responsible conduct of its whole corporate group in which case the parent company could be liable in consumer law for the conduct of its subsidiaries. For example, Vodafone includes its subsidiaries into its code of business practice: "'Vodafone' refers to Vodafone Group Plc and its subsidiaries'. See: <http://www.vodafone.com/content/dam/vodafone/about/suppliers/Business%20Principles.pdf> (last accessed: 20/11/2012)

### 6.5.1.1 The primary liability of a parent company to the employees of its subsidiary in tort

Parent companies could be directly liable in tort to the employees of their subsidiaries.<sup>1108</sup> Whereas companies are generally vicariously liable in tort to members of the public for the conduct of their employees, the specific question underlying this section is whether a parent company can owe a direct (primary) duty of care to the employees of its subsidiaries for their working conditions.<sup>1109</sup> If the parent company does owe such a duty of care itself, then it could be directly liable to the employees of its subsidiaries through the tort of negligence. This tort could, for example, provide a cause of action where employees of a subsidiary suffer injuries to their health at the factory of a subsidiary due to a breach of health and safety standards. If the employees could, in such a situation, gain a remedy against the parent company, too, then they would be in a much stronger position to recover their loss. The law would then recognise that parent companies are responsible for the conduct of their subsidiaries. As a consequence of that recognition, CSR could not simply be avoided by setting up (undercapitalised) subsidiaries.

A parent company can only be directly liable in the tort of negligence, if it owes a direct duty of care to the employees of its subsidiaries. There are some cases where English courts have held that it is, in principle, possible to show that a parent

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<sup>1108</sup> The most successful example of holding companies liable in tort law is the US Alien Tort Claims Act (ATCA) through which parent companies based in the USA can be held accountable for human rights violations by their subsidiaries abroad. Although this Act has been in existence for about two hundred years (1789), it was discovered by NGOs over 20 years ago. The ATCA confers jurisdiction on the US District Court in respect of 'any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'. The Act has been regarded to fill an accountability vacuum resulting of the non-existence of international regulation and the territorial reach of domestic laws. The landmark case of *Filartiga v. Pena-Irala* (630 F 2d 876 ((2d Cir. 1980)) ) drew attention to the potential of the ATCA as a means of holding individuals accountable for breaches of human rights standards in other countries. In this case, the court decided that non-American citizens could be punished for tortious acts committed outside the United States which were in violation of public international law (the law of nations) or any treaties to which the United States is a party. The decision therefore extends the jurisdiction of United States courts to tortious acts committed around the world. In *Sosa v Alvarez* (542 US 692 (2004)), the US Supreme Court allowed courts to hear claims by private individuals for breaches of international law committed in other countries. The number of proceedings under this Act against US parent companies has significantly increased in the past years. The fact that lawsuits are privately initiated has added to its popularity as the proceedings are not reliant on the state. There are limitations to the ATCA such as that the courts are reluctant to assume jurisdiction in cases where the claimants are not resident in the United States. Notably, the future of the Act for holding corporations accountable for human right violations is uncertain, following the decision of the Supreme Court in *Kiobel v Royal Dutch Petroleum Co.* 569 U.S.\_\_\_\_(2013), decided 17<sup>th</sup> April 2013. In that case, the Supreme Court held that the Act would only apply to conduct within the United States or on the high seas. The court held that the presumption against extraterritoriality would apply to claims under the Act and that nothing in the Act would rebut that presumption. Prior to these decisions, there has been a lot of lobbying by US corporations to the government to restrict the applicability of the ATCA. After the Supreme Court decision from April 2013 it is unlikely that the ATCA will be used largely in the future for claims against corporations based on human rights abuses committed abroad.

<sup>1109</sup> The following section will analyse the secondary liability in tort of a parent company for torts committed by its subsidiary.

company owes a direct duty of care in tort to anybody injured by a subsidiary company in a group.<sup>1110</sup> In *Connelly v RTZ*<sup>1111</sup>, an English parent company was sued in relation to injuries in a uranium mine operated by its Namibian subsidiary. The action failed as it was time-barred. However, the court held that, in principle, the parent company could have been under a direct duty of care to the employees of its subsidiary as it had taken on responsibility for devising and operating the policy for health and safety.<sup>1112</sup> In *Lubbe and Others v Cape plc*<sup>1113</sup>, it was mentioned that a parent company can, in principle, owe a direct duty of care to employees of its subsidiaries.<sup>1114</sup> However, the case was stayed on the basis of *forum non conveniens* as it was held that South Africa was the more appropriate forum. In a further case, *Ngcobo and Others v Thor Chemicals*<sup>1115</sup>, it was again held that it was arguable that a parent company may owe a duty of care to employees of its subsidiaries. This case was, however, ultimately settled.

The question of whether a parent company can owe a primary duty of care in negligence to the employees of its subsidiary was eventually decided in the recent case *Chandler v Cape plc*.<sup>1116</sup> Prior to this case that question had never been finally decided by a court as the cases were either settled or struck out for other reasons.<sup>1117</sup> *Chandler v Cape plc* concerned the question of whether the parent company (Cape plc) was directly and jointly liable with its subsidiary (which had been dissolved in the meantime) in negligence for asbestos-related injuries inflicted on the subsidiary's previous employee (the claimant). The employee had contracted asbestosis as a result to his exposure to asbestos. Both the parent company and the subsidiary were based in the UK and the conduct in question occurred in the UK.<sup>1118</sup> The case is relevant in terms of CSR, as it concerns the health of an employee which is an issue that is addressed by CSR.

In *Chandler v Cape plc*, the Court of Appeal confirmed the High Court's decision that a parent company and a subsidiary could be jointly and severally liable to pay damages for breach of the duty of care which they owed to the subsidiary's

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<sup>1110</sup> See *Connelly v RTZ Corporation PLC* [1998] AC 854; *Ngcobo and Others v Thor Chemicals Holding Ltd. And Others*, unreported January 1996, *Lubbe and Others v. Cape Plc* [2000] All ER 268.

<sup>1111</sup> *Connelly v RTZ Corporation PLC & Anor* [1999] C.L.C. 533.

<sup>1112</sup> *ibid.*

<sup>1113</sup> [2000] All ER 268.

<sup>1114</sup> See for an analysis of the case: P Muchlinski, 'Corporations in international litigation: problems of jurisdiction and the United Kingdom asbestos cases' (2001) 50 *ICCLR* 1.

<sup>1115</sup> *Ngcobo and Others v Thor Chemicals Holding Ltd. And Others*, unreported January 1996, per Maurice Kay J.

<sup>1116</sup> [2012] EWCA Civ 525 which affirms [2011] EWHC 951 (QB).

<sup>1117</sup> However, it was already argued in the academic literature that a parent company could owe a primary duty of care to tort victims of its affiliates. See, for example: J Zerk, *Multinationals and Corporate Social Responsibility – Limitations and Opportunities in International Law* (CUP 2006) 216.

<sup>1118</sup> This cases therefore no raises no questions as to the extraterritorial application of English tort law.

employee.<sup>1119</sup> The test for a duty of care (foreseeability, proximity and fair, just and reasonableness) was satisfied in the courts' opinion. The duty of care was imposed on the parent company Cape plc on the basis of an assumption of responsibility. The parent company had superior knowledge of the asbestos-related risks in general and it could and did exercise control over the business behaviour of its subsidiaries. Moreover, the parent company Cape plc dictated the overall health and safety policy. Whilst the subsidiary kept some discretion and independence in this respect, the parent company had the ability to intervene in these issues. Cape plc could therefore foresee the dangers related to asbestos and it had due proximity to the employees of its subsidiary in order to establish a duty of care. The imposition of a duty of care on the parent company was also considered to be fair, just and reasonable in this situation. Whilst confirming the High Court's decision, the Court of Appeal further outlined 'appropriate circumstances' in which 'the law may impose on a parent company responsibility for the health and safety of its subsidiary's employees':

In summary, this case demonstrates that in appropriate circumstances the law may impose on a parent company responsibility for the health and safety of its subsidiary's employees. Those circumstances include a situation where, as in the present case, (1) the business of the parent and subsidiary are in a relevant respect the same; (2) the parent has or ought to have superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary's system of work is unsafe as the parent company knew, or ought to have known; and (4) it is not necessary to show that the parent is in the practice of intervening in the health and safety policies of the subsidiary. The court will look at the relationship between the companies more widely. The court may find that element (4) is established where the evidence shows that the parent has a practice of intervening in the trading operations of the subsidiary, for example production and funding issues.<sup>1120</sup>

The courts emphasised that this issue was distinct from any question of piercing the corporate veil between a parent company and its subsidiaries which are in law separate legal entities.<sup>1121</sup> So, following the decision in *Chandler v Cape plc*, parent companies can owe a duty of care to the employees of their subsidiaries. In order to be liable in tort, it is necessary that the parent company has breached this duty of care and that it has caused the harm of the claimant.<sup>1122</sup> This decision is significant for the promotion of CSR, as the conduct of the defendant in this case violated the CSR principle to advance the interests of the employees.

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<sup>1119</sup> The High Court's decision clarified that the duty of care does not arise here just because there is a parent – subsidiary relationship, see: *David Brian Chandler v Cape plc* [2011] EWHC 951 (QB), para 66.

<sup>1120</sup> *Chandler v Cape plc* [2012] EWCA Civ 525, para 80.

<sup>1121</sup> *ibid*, para 69.

<sup>1122</sup> In *Chandler v Cape*, Cape plc was found to be in breach of its duty of care to the defendant. It was also found to have caused the harm.



The important question for the promotion of CSR in English tort law generally is to what extent this case constitutes a precedent according to which parent companies are now liable in tort to the employees of their subsidiaries.<sup>1123</sup> As indicated, previous cases had only mentioned that a parent company could owe a duty of care, but never finally decided this issue.<sup>1124</sup> *Chandler v Cape plc* is therefore an important 'incremental step' in establishing a duty of care owed by a parent company to an employee of a subsidiary.<sup>1125</sup>

First of all, it is clear from the reasoning of the court that parent companies will, in similar situations, not be vicariously liable for the liabilities of their subsidiaries as the case did not constitute a piercing of the corporate veil. This distinction is important, as one might wonder if the parent company was held to be liable for the mistakes of its subsidiaries here. The situation here is different from the piercing of the corporate veil, as it is the conduct and the knowledge of the parent company itself which gives rise to a duty of care. The decision does therefore not affect the way courts treat the separate legal status of the parent company and its subsidiaries in corporate groups. Secondly, the Court of Appeal rejected the idea of restricting the situations which can give rise to a duty of care within a group of companies. The court did so by stating that the way in which groups of companies are run differs significantly.<sup>1126</sup> This approach did not limit, for future cases, the circumstances in which a parent company can be liable for actions of its subsidiaries. The kind of relationship necessary for a duty of care to arise between the parent company and an employee of a subsidiary is therefore difficult to predict. The court emphasised that *Cape plc* as the parent company assumed responsibility by involving itself in issues relevant to health and safety policy at the subsidiary. Moreover, the court referred to *Cape's* superior knowledge about asbestos-related risks and asbestos management. This situation means that parent companies are potentially exposed to liability depending on their superior knowledge of health and safety issues and their involvement in the operation of the subsidiary (it is not necessary that this engagement consists of an

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<sup>1123</sup> The implications for multinational companies with a parent company in the UK and subsidiaries abroad such as in the developing world will be addressed later on in this chapter.

<sup>1124</sup> *Lubbe v Cape plc* [2000] 1 WLR 1545; [2000] 4 All ER 268 HL; *Connelly v RTZ Corp Plc* [1999] C.L.C. 533 QBD. In *Connelly*, there were obiter comments that, in exceptional circumstances, a parent company could owe a duty of care to the employees of its subsidiary. The exceptional circumstances included the holding company's control over the health and safety policies of a subsidiary company. The claim failed in *Connelly*, however, as the proceedings had been commenced outside the statutory time limit.

<sup>1125</sup> J Fulbrook, 'Chandler v Cape: personal injury: liability: negligence' [2012] *Journal of Personal Injury Law* C135.

<sup>1126</sup> The Court of Appeal made the following comment in this respect: 'Moreover, the way in which groups of companies operate is very varied. Sometimes, for example, a subsidiary is run purely as a division of the parent company, even though the separate legal personality of the subsidiary is retained and respected. Accordingly, it is simply not possible to say in all cases what is or is not a normal incident of that relationship.' *Chandler v Cape Plc* [2012] EWCA Civ 525, para 67.

intervention in the health and safety policies of the subsidiary). Upon that basis, an important consequence of the court's reasoning is that a parent company with superior knowledge of health and safety issues cannot avoid liability purely by not engaging with such matters of the subsidiary if it is or ought to be aware of circumstances that could create such a risk (e.g. when the parent and the subsidiary company are doing business in the same area) and when it gets involved in some aspects of the operation of the subsidiary.

Consequently, the precedent set by *Chandler v Cape plc* makes the CSR principle of providing a safe workplace a much more important consideration for parent companies within corporate groups as they are not able to avoid liability in tort purely by setting up several subsidiaries. The possibility that parent companies can be primarily liable in tort for the conduct of their subsidiaries significantly enhances the position of CSR within companies. The decision impacts on the way parent companies must administer risks within their group.<sup>1127</sup> Parent companies cannot easily avoid responsibility for the employees of their subsidiaries. The decision provides potential for English tort law to better promote the socially responsible conduct of companies, as tort victims can sue the parent company (which is often more solvent) in the tort of negligence. However, it is unlikely that the precedent set by *Chandler v Cape plc* expands to parent companies that do not get involved in the running of their subsidiaries at all. Moreover, it is not possible to foresee to what extent the decision in *Chandler v Cape plc* has paved the way for an increased liability of parent companies for the violation of CSR principles other than the health and safety at the workplace, for example, where the subsidiary interferes with the physical integrity of its employees. After all, the Court of Appeal did not establish a duty of care owed by the parent company to the employees of its subsidiaries purely on the grounds of it being the parent company. A final point is that the case has potential to expand the liability of English parent companies to the employees of their subsidiaries abroad, if the criteria of the above-mentioned test for the duty of care are met. However, if a court will indeed be prepared to establish a duty of care in such a situation is not foreseeable yet. The case is therefore a first step in the right direction in terms of holding parent companies accountable, but it remains to be seen to what extent it will promote the socially responsible conduct within a corporate group overall.

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<sup>1127</sup> The question if, following *Chandler v Cape*, parent companies are potentially also exposed to liability in negligence towards the employees of their foreign subsidiaries abroad will be addressed below.

### 6.5.1.2 The vicarious liability of a parent company for the tort liabilities of its subsidiaries (piercing the corporate veil)

The direct liability of parent companies in tort to the employees of their subsidiaries, discussed in the previous section, needs to be distinguished from the issue of whether a parent company can be vicariously liable for the tort liabilities of its subsidiaries through the mechanism of piercing the corporate veil. If the corporate veil is pierced, then the parent company would be required to cover the liabilities of its subsidiaries. The idea behind such a claim is that parent companies often establish diversified group structures with many wholly-owned subsidiaries in order to reduce their liability risk.<sup>1128</sup> The ability to hold parent companies vicariously liable could significantly improve the ability of tort victims to obtain compensation, especially when subsidiary companies are undercapitalised.<sup>1129</sup> Such vicarious liability of parent companies could therefore promote CSR, as parent companies would no longer be able to avoid their liability in tort for conduct which violates CSR principles through the setting up of subsidiaries, for example where their subsidiaries commit human rights abuses.

In law, the subsidiaries are separate legal entities from the parent company following the decision in *Salomon v Salomon & Co Ltd*.<sup>1130</sup> The decision in *Salomon v Salomon* established that a company is a legal entity separate and distinct from its shareholders.<sup>1131</sup> The members of the company are only liable for the debts of the company in the amount of their non-paid up share capital.<sup>1132</sup> The legitimacy that the courts gave to single-man companies in the *Salomon* decision has been expanded to corporate groups.<sup>1133</sup> The legal position is that all companies in a group of companies are separate legal entities, even in case of wholly-owned subsidiaries with only little paid-up share capital and a board of directors which predominately or solely consists of directors who are also directors of the parent company.<sup>1134</sup> Parent companies are vicariously liable for the torts committed by their subsidiary

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<sup>1128</sup> S1159 CA 2006 defines subsidiaries and holding companies. According to that definition, a company is a 'subsidiary' of another company, its 'holding company', if that other company - (a) holds a majority of the voting rights in it, or (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or if it is a subsidiary of a company that is itself a subsidiary of that other company.

<sup>1129</sup> The fact that there is no minimum capital fund required for the founding of a private limited company means that parent companies can create several subsidiaries without providing them with any financial means.

<sup>1130</sup> [1897] AC 22.

<sup>1131</sup> *ibid*.

<sup>1132</sup> S3 (2) CA 2006. Shares are usually fully-paid up. S74 (1) (d) IA 1986 clarifies that, 'in the case of a company limited by shares, no contribution is required from any member exceeding the amount (if any) unpaid on the shares in respect of which he is liable as a present or past member.'

<sup>1133</sup> *Adams v Cape Industries plc* [1990] BCLC 479, 520.

<sup>1134</sup> See B Hannigan, *Company Law* (3rd ed., OUP 2012) para 3-35.

companies when the courts are prepared to 'pierce the corporate veil' which means that the separate legal personality of a company is disregarded and the shareholders are liable for the company.<sup>1135</sup> The question of the separate legal status of subsidiary companies has undergone a mixed review in the case law. In *DHN Food Distributors Ltd v Towler Hamlets BLC*<sup>1136</sup>, the Court of Appeal treated a group of tightly controlled companies as an economic unit and consequently ignored the separate legal personality of the companies. It was held that the share ownership of the parent company and its influence on its subsidiaries provides an argument that, in reality, these companies are 'one economic unit'.<sup>1137</sup> This approach was subsequently criticised by the House of Lords in *Woolfson v Strathclyde Regional Council*<sup>1138</sup> where the court stated that it had 'some doubt whether in this respect the Court of Appeal had properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts'. The House of Lords did not overrule the DHN case, but distinguished it on the facts.<sup>1139</sup> According to the mere façade test it is appropriate to pierce the corporate veil only where special circumstances exist which indicate that the company is a mere façade which conceals the true facts. The liability of parent companies for the conduct of their subsidiaries was then comprehensively reviewed by the Court of Appeal in *Adams v Cape Industries plc*.<sup>1140</sup> The defendant, *Cape Industries plc*, operated a network of subsidiaries which were involved in asbestos mining. The Court of Appeal applied a strict approach to the question of piercing the corporate veil and dismissed the idea of a single economic unit between the parent company and its subsidiaries. This concept could not justify any departure from the principle that companies in a group of companies are separate legal entities. The court held that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that the corporate veil is a mere façade concealing the true facts, i.e. where the corporate structure is used to evade rights of relief that third parties may in the future acquire. Moreover, the court held that the situations where a subsidiary can be considered to be the agent of a parent company (which would also enable courts to pierce the corporate veil) must be confined to those instances where this was factually justified.

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<sup>1135</sup> Other expressions apart from 'piercing' in this context are: 'setting aside', 'lifting' or 'going behind' the veil. See: D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (28<sup>th</sup> edn, OUP 2011-12) para 5.3.2.2.

<sup>1136</sup> [1976] 1 WLR 852.

<sup>1137</sup> *ibid*, per Lord Denning, 860.

<sup>1138</sup> (1979) 38 P & CR 521.

<sup>1139</sup> *ibid*, 526.

<sup>1140</sup> [1990] BCLC 479.

The court emphasised that it would be difficult to prove an agency relationship where there was no express agreement.<sup>1141</sup>

Slade LJ noted:

There is no general principle that all companies in a group of companies are to be regarded as one. On the contrary, the fundamental principle is that “each company in a group of companies (a relatively modern concept) is a separate legal entity possessed of separate legal rights and liabilities”: see *The Albazero* [1975] 3 All ER 21, 28.<sup>1142</sup>

Moreover, Slade LJ stated that the use of the corporate group by a parent company as a means to ensure that legal liability and the risk of enforcement of that liability in respect of future activities of the group will fall on another member of that group was ‘inherent in our corporate law’.<sup>1143</sup>

The consequence of accepting that parent companies can use a corporate group structure to ensure that the liability will fall on its subsidiaries as ‘inherent’ in English law means that tort victims will not be able to hold parent companies vicariously liable for the conduct of their subsidiaries unless the subsidiary is a mere façade or there is an agency relationship. Parent companies can therefore usually avoid liability for violations of CSR by their subsidiaries. Given that the use of corporate group structures is now widespread, the approach by English courts to the issue of group liability puts tort victims as involuntary creditors at a severe disadvantage.<sup>1144</sup> It is difficult to justify that a solvent parent company can easily limit its potential liability by founding several (undercapitalised) subsidiaries. The ability of a tort victim of a company within such a corporate group to fully recover the loss resulting from a tort depends on which company of that group has committed the tort.<sup>1145</sup> Villiers therefore notes that

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<sup>1141</sup> *ibid*, 545-549.

<sup>1142</sup> *ibid*, 508.

<sup>1143</sup> In this case the court held that: ‘...we do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this way is inherent in our corporate law.’, see: [1990] BCLC 479, 520.

This issue will be discussed in detail in the next section.

<sup>1144</sup> Shirley Quo critically reviews the avoidance of tort liability through a corporate group structure with subsidiaries in Australia. She discusses suggestions to reform Australian company law so that the application of the limited liability principle would be restricted in relation to claims for personal injury against the holding companies. See: S Quo, ‘Corporate social responsibility and corporate groups: the James Hardie case’ (2011) 32 *Company Lawyer* 249, 252.

<sup>1145</sup> It is necessary to distinguish between different kinds of creditors. In contracts, banks and lenders will usually be able to contract out of the limited liability by securing guarantees from the parent company. Moreover, it can be argued that holding companies will often compensate economically powerful creditors, as they might depend on that partner in the long run. See: J Birds et al., *Boyle &*

the combination of limited liability with separate legal personality makes a lethal cocktail for victims of harmful endeavours in terms of their ability to pursue a company or its shareholders for compensation.<sup>1146</sup>

The parent company will be shielded from any liability.<sup>1147</sup> Instead, in case of tort victims, the risk is allocated to the poorer risk taker.<sup>1148</sup> This situation appears particularly unsatisfactory with regard to closely held companies in a corporate group which are all wholly-owned by the parent company. Limited liability was developed in the 19<sup>th</sup> century in order to promote economic activities, particularly to enable investors to provide assets without the risk of incurring liabilities.<sup>1149</sup> It can be argued that the reality of corporate group structures in the 21<sup>st</sup> century which are used to diversify risks has nothing in common with the reasons for granting limited liability in the first place.

Violations of CSR by subsidiary companies within a group therefore pose a particular challenge for the promotion of CSR through tort law. The corporate group structure can ensure that parent companies, despite close factual relations with their subsidiaries, do not have to cover for their subsidiaries' tort liabilities, for example, where the subsidiary is liable to its employees for assault, battery, false imprisonment or negligence. The denial of the 'single economic unit concept' by the Court of Appeal in *Adams v Cape Industries plc* severely restricts the ability of English tort law to promote CSR. The criticism can be made that this approach is outdated, given that in the more than twenty years which have gone since that decision, the use of corporate groups by parent companies has significantly been expanded. In fact, the widespread use of corporate groups often serves the very function of avoiding liability.<sup>1150</sup>

Therefore, a case can be made that, within a group, the parent company should be made responsible to satisfy the tort obligations of its subsidiaries. It has been suggested to introduce a statutory rule that attributes liability to the parent company

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*Birds' Company Law*, (8th edn, Jordan Publishing 2011) para 3.10.2; B Hannigan, *Company Law* (3<sup>rd</sup> edn, OUP 2012) paras 3-44–3-51.

<sup>1146</sup> C Villiers, 'Corporate law, corporate power and corporate social responsibility' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 95.

<sup>1147</sup> S Baughen, 'Multinationals and the Export of Hazard' (1995) 58 *Modern Law Review* 54, 70.

<sup>1148</sup> P Muchlinski, 'Limited liability and multinational enterprise: a case for reform?' (2010) 34 *Cambridge Journal of Economics* 915, 918, 923.

<sup>1149</sup> *ibid*, 917. See for an overview of the development of limited liability in Anglo-American law, particularly with regard to corporate groups: P Blumberg, 'Limited Liability And Corporate Groups' (1985-1986) 11 *J. Corp. L.* 573.

<sup>1150</sup> The current position is further evident in the following comment about the use of subsidiary companies made in *Re Southard Ltd*: 'A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of the creditors, the parent company and other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.' See: *Re Southard Ltd* [1998] 2 BCLC 447, 458.

for the negligent acts of the subsidiary on the basis of the enterprise liability principle.<sup>1151</sup> This approach would provide tort victims suffering from a tortious act which violates CSR principles, for example, environmental pollution resulting in damage to property, with a much better chance of receiving damages. The parent company could then not simply avoid liabilities by setting up subsidiary companies to carry out the risky activities. This concept would be a move towards the single economic unit concept (also called enterprise based approach) that takes account of the economic realities within the corporate group.<sup>1152</sup> The imposition of liability on parent companies for their subsidiaries to involuntary tort creditors can be justified by the argument that parent companies exercise de-facto control over their subsidiaries (and thereby benefit from the profits), but, currently, do not face any liability for the conduct of their subsidiaries.<sup>1153</sup> Moreover, whilst, at least in theory, contractual creditors can contract out of limited liability by securing personal guarantees, tort creditors do not have the opportunity to choose who their creditors are going to be.<sup>1154</sup> This argument further supports the imposition of liability on parent companies for torts committed by their subsidiaries. It is disappointing that the Company Law Review Steering Group, when discussing the Companies Act 2006, opted against a change in the law with respect to the liabilities of the parent company for its subsidiaries. The Steering Group did so, even though it conceded that the arguments in favour of the legal status quo (allowing companies to take advantage of limited liability by forming subsidiaries) were less strong in terms of tort victims than in relation to contracts voluntarily entered into by the contractual partners.<sup>1155</sup> Nevertheless, the Steering Group decided not to address the issue of group liability as it did not find evidence that parent companies abuse the corporate status in order to avoid liabilities:

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<sup>1151</sup> P Muchlinski, 'Limited liability and multinational enterprise: a case for reform?' (2010) 34 *Cambridge Journal of Economics* 915, 926. See also: N Mandelson, 'A control-based approach to shareholder liability for corporate torts' (2002) 102 *Columbia Law Review* 1203.

<sup>1152</sup> See for the idea that parent companies should be liable for the debts of their subsidiaries: C Schmitthoff, 'The wholly owned and the controlled subsidiary' [1978] *JBL* 218. See for an overview of the 'enterprise entity' doctrine: P Muchlinski, *Multinational Enterprises & The Law* (2<sup>nd</sup> edn, OUP 2007) 317.

<sup>1153</sup> See for a discussion of the combination of limited liability with control rights: P Ireland, 'Limited liability, shareholder rights and the problem of corporate irresponsibility' (2010) 34 *Cambridge Journal of Economics* 837, 853.

<sup>1154</sup> But it must be taken into account that the bargaining power of contractual partners to contract out of limited liability will significantly vary. That means that banks will usually be in a position to secure a personal guarantee whereas small traders are unlikely to be in such a strong position.

<sup>1155</sup> Company Law Review, *Completing the Structure* (DTI 2000) para 10.58

The under-capitalisation of subsidiaries, and their operation in a way which creates undue risks of insolvency, are matters best dealt with by insolvency law. We do not therefore propose any reforms in this regard.<sup>1156</sup>

In the wake of the global economic and financial crisis, it has become apparent that this position taken by the Steering Group was based on a false assumption. The group accounts which a parent company must now prepare pursuant to s399 (2) CA 2006 are a consolidated balance sheet and consolidated profit and loss account for the whole group.<sup>1157</sup> They provide for some disclosure, but do not provide any help for the involuntary tort creditor of a subsidiary as he cannot check the accounts of a group of companies before he becomes their tort victim. It is therefore argued here that English law could better promote CSR if it abandoned its current approach to corporate groups, according to which parent companies are only liable for the liabilities of their subsidiaries in rare circumstances (e.g. where the corporate veil is pierced). Instead, the parent company should be liable to compensate the tort creditors of those subsidiaries which are unable to pay the damages. The fact that parent companies must prepare consolidated group accounts under the Companies Act 2006 already recognises the close relationship within the corporate group and further supports this view.

The use of complex corporate group structures in an international context by Western multinational companies further complicates the issue of holding parent companies to account for torts committed by their subsidiaries. However, it must be noted that this chapter (as does the thesis overall) focusses on the ability of English private law to promote the socially responsible conduct of companies whenever English law applies. It is therefore beyond the scope of this chapter to analyse under what circumstances English tort law is applicable for torts committed abroad, particularly in countries of the developing world which often have a lower standard of workplace health and safety.<sup>1158</sup> The issue of extraterritorial application of English tort law, particularly for human rights abuses committed either directly or through subsidiaries in the developing world, is an issue that cannot be addressed

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<sup>1156</sup> *ibid*, para 10.59. See for a critical assessment of the Steering Group's approach: P Muchlinski, 'Holding multinationals to account: recent developments in English litigation and the Company Law Review' (2002) *Company Lawyer* 168, 173.

<sup>1157</sup> S404 CA2006.

<sup>1158</sup> The territorial reach of English tort law is of particular interest, as there are many reported violations of CSR principles by the subsidiaries of English companies in the developing world, for example, human rights abuses. See: *The Guardian*, 'Apple factories accused of exploiting Chinese workers', 30 April 2011, available at: <http://www.guardian.co.uk/technology/2011/apr/30/apple-chinese-factory-workers-suicides-humiliation?INTCMP=SRCH>; *The Independent*, 'Leading article: The gruesome reality of sweatshops', 1 October 2010, available at: <http://www.independent.co.uk/opinion/leading-articles/leading-article-the-gruesome-reality-of-sweatshops-2094318.html?origin=internalSearch> (last accessed: 21/04/2013); R Locke et al., 'Beyond corporate codes of conduct: Work organization and labour standards at NIKE's suppliers' (2007) 146 (1-2) *International Labour Review* 21, 21.



adequately within the space available in this thesis.<sup>1159</sup> It would be an interesting topic for subsequent research. This chapter has therefore not discussed to what extent the decision in *Chandler v Cape plc* has created a way to sue English multinational companies for the torts committed by their overseas subsidiaries.

### 6.5.2 Access to civil litigation

Apart from the existence of corporate group structures, the other main challenge of using tort law as a means to promote greater corporate social responsibility is the access to civil litigation for claimants. This section will address two particular issues that restrict the access to civil litigation for tort victims, namely the availability of class actions and the funding of civil litigation.

#### 6.5.2.1 Mass torts: Class actions

Corporate conduct that violates CSR principles may well harm more than just one person. For example where a company has, as in the hypothetical scenario used for this chapter, emitted toxic gases, it could easily harm the health of numerous employees as well as several members of the local community. The number of people who suffer injuries from coming into contact with these toxic gases could easily reach hundreds or more. In such a situation the use of tort law as an instrument of promoting greater CSR would be more effective where those tort victims who have been injured under similar circumstances could bring a class action.

Where there are several claims related to similar issues of fact or law, civil procedure laws provide a system for the management of such cases called Group Litigation Order (GLO).<sup>1160</sup> Pursuant to Rule 19.10 Civil Procedure Rules, a GLO

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<sup>1159</sup> Some authors have suggested that the decision in *Chandler v Cape plc* might result in liabilities of English companies to the employees of their foreign subsidiaries. See for example: 'Chandler v Cape Plc: Is there a chink in the corporate veil? (Case comment)' (2012) 18 (3) *Health & Safety at Work*, 1, 2. This chapter will not engage with the details of private international law, but it must be stated here that it is doubtful if the opinion voiced by some authors that English parent companies might now be liable for torts committed abroad is a correct interpretation of the law. The law applicable to non-contractual obligations is determined by the Rome II Regulation. Pursuant to Article 4 (1) of the Regulation, the law applicable to a non-contractual obligation arising out of a tort/delict shall be the law of the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur. Generally speaking, the law applicable to torts is usually the local law of the place where the damage occurs. See: C Clarkson and J Hill, *The Conflicts of Law* (4<sup>th</sup> edn, OUP 2011) 265.

<sup>1160</sup> Ministry of Justice, Group Litigation Orders, <http://www.justice.gov.uk/courts/rcj-rolls-building/queens-bench/group-litigation-orders> (last accessed: 5/3/2013). See also: C Hodges, *Multi-party actions* (OUP 2001). The Civil Procedure Rules also provide representative actions pursuant to Rule 19.6 CPR. These actions may be made by (or against) one or more persons who have the 'same interest' in a claim. One or more of the persons can then be representatives of any other persons who have that same interest, i.e. the named claimant or defendant prosecutes or defends an action on both his behalf and on behalf of a class of individuals (Rule 19.6: '1) Where more than one person has the same interest in a claim – (a) the claim may be begun; or (b) the court may order that the claim be

means an order made under rule 19.11 to provide for the case management of claims which give rise to common or related issues of fact or law (the 'GLO issues'). The Senior Master and the Law Society maintain a list of GLOs.<sup>1161</sup> There are several procedural requirements for GLOs. The main features of GLOs were summarised by Lord Walker in *Autologic Holdings plc v Commissioners of Inland Revenue*.<sup>1162</sup> According to this summary, a GLO identifies the common issues which are a pre-condition for participation in a GLO, it provides for the establishment and maintenance of a register of GLO claims and it gives the managing court wide powers of case management and issuing directions. If the group loses the case, each group member is liable for that member's share of the common costs of the proceedings and for any individual costs specifically incurred with respect to his claim.<sup>1163</sup> The GLO system has particularly been criticised for the requirement that claimants need to 'opt in', as it would prevent claimants from being part of the GLO and as it would reduce the overall number of GLOs.<sup>1164</sup> The current system is therefore criticised for restricting access to justice, particularly in light of the few GLOs that have been made since the introduction of this system in the year 2000.<sup>1165</sup> Consequently, the Civil Justice Council<sup>1166</sup> published a report in 2008 in which it recommended, inter alia, that England and Wales should introduce a generic collective action and adopt an opt-out system of collective action, capable of awarding aggregate damages.<sup>1167</sup> In its response to the report, the government did not support the introduction of a generic right of collective action.<sup>1168</sup> It rather suggested that such rights should be considered for specific sectors only.<sup>1169</sup> Similarly, the government was of the view that the opt-out systems should only be

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continued, by or against one or more of the persons who have the same interest as representatives of any other persons who have that interest.'). The 'same interest' was narrowly interpreted in *Emerald Supplies Ltd and another v British Airways plc* [2010] EWCA Civ 1284 which limits the scope of representative actions.

<sup>1161</sup> A list of Group Litigation Orders can be found at: <http://www.justice.gov.uk/courts/rcj-rolls-building/queens-bench/group-litigation-orders> (last accessed: 21/04/2013).

<sup>1162</sup> [2005] UKHL 54; [2006] 1 AC 118, at [86].

<sup>1163</sup> N Andrews, 'Multi-Party Actions and Complex Litigation in England' (2012) 23 *E.B.L. Rev.* 1.

<sup>1164</sup> R Mulheron, 'Justice Enhanced: Framing an Opt-Out Class Action for England' (2007) 70 *MLR* 550, 580.

<sup>1165</sup> Mulheron Report, *Reform of Collective Redress in England and Wales* (2008), available at: [www.civiljusticecouncil.gov.uk/files/collective\\_redress.pdf](http://www.civiljusticecouncil.gov.uk/files/collective_redress.pdf) (last accessed: 4/3/2013), chapter 3; Statistics provided by the Ministry of Justice on its website (last updated 12 February 2013) show that there have been 76 orders since the year 2000, see: <http://www.justice.gov.uk/courts/rcj-rolls-building/queens-bench/group-litigation-orders> (available at: 6/3/2013).

<sup>1166</sup> The Civil Justice Council (CJC) is an independent public body, funded by the Ministry of Justice. See: <http://www.judiciary.gov.uk/about-the-judiciary/advisory-bodies/cjc> (last accessed: 21/04/2013).

<sup>1167</sup> Civil Justice Council, *Improving Access to Justice through Collective Actions: Developing a More Efficient and Effective Procedure for Collective Actions*, Final Report (November 2008), available at: <http://www.judiciary.gov.uk/JCO%2FDocuments%2FCJC%2FPublications%2FCJC+papers%2FCJC+improving+Access+to+Justice+through+Collective+Actions.pdf> (last accessed: 5/3/2013).

<sup>1168</sup> Ministry of Justice, *The Government's Response to the Civil Justice Council's Report: Improving Access to Justice through Collective Actions* (July 2009).

<sup>1169</sup> See for a critical discussion of this approach: R Mulheron, 'Recent milestones in class actions reform in England: A critique and a proposal' (2011) 127 *LQR* 288.

introduced for specific sectors rather than as a full opt-out model.<sup>1170</sup> As part of this 'sector-specific' reform, the Department for Business Innovation and Skills (BIS) published a consultation paper in April 2012 which, inter alia, considered the introduction of wider collective actions and different collective redress models in competition law.<sup>1171</sup> Following the consultation, the government has now decided to introduce a limited opt-out collective actions regime, albeit only for competition law.<sup>1172</sup> At the same time, the European Commission is currently also considering the area of collective redress in competition law.<sup>1173</sup> All these developments have in common that the move towards amending the currently rather restricted system of class action so far only focusses on competition law. Changes to actions in tort by multiple claimants, e.g. for physical injury, are not likely to be introduced in the foreseeable future. This situation limits the ability of tort law to effectively promote CSR by providing a means of redress for groups of people who have suffered harm as the consequence of irresponsible corporate conduct.

#### 6.5.2.2 Funding of actions in tort

With regard to the cost of litigation, civil claims in personal injury cases are often funded by conditional fee agreements.<sup>1174</sup> These agreements have become popular since the public funding for personal injury claims had been significantly reduced through the Access to Justice Act 1999.<sup>1175</sup> Under these conditional fees arrangements, commonly known as 'no win-no fee' system, the claimant's lawyer will not charge any fees if his client loses the case, but may charge an uplift of up to 100% of his normal fees from the other party if he wins.<sup>1176</sup> This system is important for claimants with limited financial resources due to the restricted availability of public funding for civil litigation.<sup>1177</sup> Whilst the party that has lost a case generally pays its own costs as well as the costs of the successful party<sup>1178</sup>, the main hurdle for claimants is to fund the costs of their claim in the first place. The purpose of this

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<sup>1170</sup> *ibid.*

<sup>1171</sup> BIS Department for Business Innovation & Skills, *Private actions in competition law: A consultation on options for reform* (April 2012), available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31528/12-742-private-actions-in-competition-law-consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31528/12-742-private-actions-in-competition-law-consultation.pdf) (last accessed: 21/04/2013).

<sup>1172</sup> BIS Department for Business Innovation & Skills, *Private actions in competition law: A consultation on options for reform - government response* (January 2013), available at: [https://whitehall-admin.production.alpha.gov.co.uk/government/uploads/system/uploads/attachment\\_data/file/70185/13-501-private-actions-in-competition-law-a-consultation-on-options-for-reform-government-response1.pdf](https://whitehall-admin.production.alpha.gov.co.uk/government/uploads/system/uploads/attachment_data/file/70185/13-501-private-actions-in-competition-law-a-consultation-on-options-for-reform-government-response1.pdf) (last accessed: 21/04/2013).

<sup>1173</sup> See: [http://ec.europa.eu/consumers/redress\\_cons/collective\\_redress\\_en.htm](http://ec.europa.eu/consumers/redress_cons/collective_redress_en.htm) (last accessed: 21/04/2013).

<sup>1174</sup> S27 Access to Justice Act 1999.

<sup>1175</sup> BBC News, 'Legal aid axed for personal injury claims' (4 March 1998), available at: <http://news.bbc.co.uk/1/hi/uk/61882.stm> (last accessed: 21/04/2013).

<sup>1176</sup> S4 The Conditional Fee Agreements Order 2000.

<sup>1177</sup> N Andrews, 'Multi-Party Actions and Complex Litigation in England' (2012) 23 E.B.L.Rev. 1.

<sup>1178</sup> Rule 44.3 (2) Civil Procedure Rules 1998.

conditional fee agreement is therefore to encourage lawyers to accept greater risks and hence to promote access to justice.<sup>1179</sup> However, the government has now made significant changes to this system with the enactment of the Conditional Fee Agreements Order 2013. Under the new regulation, solicitors may still enter into a Conditional Fee Agreement with their clients, but the clients, if successful with their claim, will no longer be able to recover their solicitor's success fee from the defendant.<sup>1180</sup> If their claim is successful, they will be forced to pay their solicitor's success fee (on a contingency fee basis).<sup>1181</sup> It is to be expected that, as a consequence of this change, solicitors will find it less attractive to accept cases where the claimant cannot afford the initial cost of litigation.<sup>1182</sup> The number of claims in personal injury cases for torts is therefore likely to decline. This situation is particularly dissatisfying, given that in personal injury cases that concern irresponsible conduct of companies, there is often the private individual with limited financial means on the one side and the company with far better financial means on the other side.<sup>1183</sup>

Consequently, the access to civil litigation for tort victims is limited. The restricted use of class actions for tort victims through GLOs has, so far, only resulted in few orders being made. Moreover, following the changes to the conditional fee agreement system, the number of tort victims who will be able to bring a claim against the tortfeasor is likely to decline. The potential of tort law to promote greater corporate social responsibility is therefore likely not to be fully used because of the difficulties with accessing civil litigation for private claimants. In order to better promote CSR it would be necessary to expand the use of class action by providing an 'opt out' system and to overcome the financial hurdle that the initiation of civil litigation currently establishes.

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<sup>1179</sup> R Meeran, 'Multinationals will profit from the government's civil litigation shakeup', *The Guardian* (London, 24 May 2011), <http://www.guardian.co.uk/commentisfree/libertycentral/2011/may/24/civil-litigation-multinationals> (last accessed: 5/3/2013).

<sup>1180</sup> The Conditional Fee Agreements Order 2013, available at: <http://www.legislation.gov.uk/ukdsi/2013/9780111533437> (last accessed: 6/3/2013).

<sup>1181</sup> See for an overview of the recent changes to the funding of personal injury claims: E Gretton, 'Jackson – an overview' *The Law Society Gazette* (27 March 2013), available at: <http://www.lawgazette.co.uk/blogs/blogs/in-business-blog/jackson-overview> (last accessed: 21/04/2013).

<sup>1182</sup> R Meeran, 'Multinationals will profit from the government's civil litigation shakeup', *The Guardian*, (London, 24 May 2011), <http://www.guardian.co.uk/commentisfree/libertycentral/2011/may/24/civil-litigation-multinationals> (last accessed: 5/3/2013).

<sup>1183</sup> Particularly multinational companies usually employ highly-specialised legal teams in order to avoid losing the case. Large companies are particularly driven by the fear of reputational damage in case they lose the case.

## 6.6 Conclusion

This chapter has shown that, despite its limitations, English tort law already makes an important contribution to the promotion of CSR in private law. Tort law and CSR overlap where tort provides causes of action for the violation of CSR principles, for example the health and property of some of the company's stakeholders such as its employees or the local community. Tort law provides several groups that are, by definition, encompassed by CSR, with a remedy in tort for the violation of their interests (which overlap with CSR) such as the employees and the local community. Through the provision of legal remedies, tort law is a means of enforcing CSR principles. Moreover, as tort law develops incrementally, it can be influenced by CSR, as the idea of the socially responsible conduct of companies can increasingly influence the standard of breach of duty and considerations of when it is 'fair, just and equitable' to impose a duty of care. The findings of this chapter further challenge the view that CSR is purely 'voluntary'.

As tort law can therefore be used as an instrument to enforce the socially responsible conduct of companies, it appears, at first sight, to be a strong tool for the promotion of CSR. However, in fact, tort law is restricted in its ability to enhance greater social responsibility of corporations in a number of ways. First, despite its contribution to the promotion of CSR, tort law protects personal interests such as health and property. The right to action is limited to those persons whose property or other personal interests have been harmed. In consequence, the pollution of the environment is only addressed by tort law to the extent that natural or legal persons have suffered harm. The environment itself does, therefore, not receive compensation in tort that would require the company (the tortfeasor) to restore the harm done or to balance the harm by investing in environmental protection measurements elsewhere. This dependence on private interests severely limits the ability of tort law to control the pollution of the environment, which is a key aspect of CSR.

Secondly, tort law is primarily reactive and compensatory. The primary objective of tort law remains to provide compensation for the tort victim who suffers from a civil wrong committed by another party.<sup>1184</sup> Actions in tort are brought when the tort has already occurred and the main aim of tort is to compensate the tort victim for the injury sustained. Exemplary damages which could deter companies from irresponsible conduct are only rarely awarded. As torts are primarily compensatory

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<sup>1184</sup> V Harpwood, *Modern Tort Law* (6th edn, Cavendish Publishing 2005) para 1.10.

the interests that CSR aims to promote are only promoted to the extent that the claimant is compensated. The restricted use of injunctions further limits the ability of tort law to promote CSR, as in many situations an injunction would be an appropriate remedy in order to stop the company from continuing with committing the tort. Due to their direct impact on the behaviour of a company, the more frequent award of injunctions would be a powerful tool for the promotion of CSR.

Thirdly, the ability of private parties to make use of the potential of tort law as an instrument to promote greater CSR is limited due to the difficulty with accessing justice. This situation is down to two issues: The restricted availability of class actions in tort and the recent changes to the funding of civil litigation. Finally, the particular challenge for using tort law in the context of CSR is that many companies operate corporate group structures in order to diversify their risk of incurring liability. The strict adherence to the *Salomon v Salomon* principle within corporate group structures, i.e. that each company is a separate legal entity and not liable for the liabilities of the other companies, does not pay sufficient regard to the fact that, in reality, the parent company often controls the subsidiary and uses the subsidiary as a tool to gain profit for the parent without the need to compensate for its losses. This situation is not fair for a tort victim of a subsidiary whose claim cannot be compensated by that subsidiary, particularly where subsidiaries are undercapitalised. The enforcement of CSR standards through tort law is therefore restricted by legal and financial hurdles.

The recent decision in *Chandler v Cape plc* with its imposition of a primary duty of care on the parent company in specific circumstances is a first step into the right direction in terms of holding parent companies accountable. Following this precedent, tort law now has a wider reach in respect of violations of CSR principles. It is, however, unclear to what extent this decision will pave the way for violations of CSR principles other than the breach of health and safety standards at a production site run by a subsidiary. Moreover, the level of engagement that is required by a parent company in the running of the subsidiary is not clarified, thus leaving it open to speculation if this case is, in practice, going to enable many more successful lawsuits against parent companies.

Tort law could better promote CSR, if some of its weaknesses were addressed. The fundamental step would be to introduce a more integrated approach to liability within corporate groups where parent companies could be made liable for tort liabilities of their subsidiaries. Moreover, injunctions and exemplary damages should be more frequently available, as these are particularly suitable for the promotion of CSR.

Finally, the access to civil litigation for tort victims must be facilitated. To that end, the demise of the conditional fee agreements must be reversed and the provision of class actions be expanded.





# Chapter 7: Conclusion - The promotion of CSR in English private law

## 7.1 Introduction: Private law and CSR

It was argued at the beginning of this thesis that, for too long, CSR has been captured in binary debates between a voluntary (soft law) and a mandatory (hard law) approach.<sup>1185</sup> Particularly business organisations have argued and continue to argue that CSR is a purely voluntary concept, beyond the law<sup>1186</sup>, although, as this thesis has shown, law and CSR are, in fact, related in a number of ways. The dichotomy about voluntary or mandatory approaches to CSR is not only a superficial and inaccurate account of the relationship between law and CSR<sup>1187</sup>, but it has also restricted the developing understanding of CSR in law.<sup>1188</sup> This thesis is based on the argument that the literature on CSR and the law has, so far, largely neglected the contribution that private law<sup>1189</sup> makes or could make to the promotion of CSR.<sup>1190</sup> The four areas of private law that were analysed in this thesis have demonstrated that private law plays an important role for CSR in various ways, for example, through director's duties and the business review in company law, the incorporation of CSR standards into supply chain contracts, the liability in tort for violations of CSR principles and, if the recommendations of the Law Commission are implemented, also through a private remedy of consumers in relation to misleading business practices.

Whilst it is accepted that there are limitations to the promotion of CSR in English private law, it is argued in this thesis that private law has made and can continue to

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<sup>1185</sup> See K Buhmann, 'Integrating human rights in emerging regulation of corporate social responsibility: the EU case' (2011) *International Journal of Law in Context* 139, 147; J Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 32.

<sup>1186</sup> See, for example, statements made by The Confederation of Business Industry (CBI), available at: <http://www.cbi.org.uk/ndbs/content.nsf/802737AED3E3420580256706005390AE/9D502144AC9F644380256F58005BD16C> (last accessed 03/10/2012). The Department for Business, Innovation and Skills follows a similar line of argument, see: <http://www.bis.gov.uk/policies/business-sectors/low-carbon-business-opportunities/sustainable-development/corporate-responsibility> (last accessed 12/12/2012).

<sup>1187</sup> For example, chapter 4 on supply chain contracts and chapter 5 on consumer protection law have shown that CSR commitments, which a company voluntarily undertakes, can be enforceable.

<sup>1188</sup> For example, the duty to promote the success of the company for the benefit of its members as a whole in s172 (1) CA overlaps with CSR.

<sup>1189</sup> See chapter 1 for the discussion about the definition of private law. This thesis has adopted the definition of private law, suggested by Lord Woolf. He defines private law as the system which protects the private rights of private individuals or the private rights of public bodies. For him, the function which is performed is the essential criterion for distinguishing between public law and private law. If the function is a governmental activity, then it is public law. See: Lord Woolf, 'Droit public – English style' [1995] *PL* 57, 62.

<sup>1190</sup> The word 'to promote' is not a legal term. As outlined in chapter 1, it is used here to describe the role that English private law plays in the support, encouragement and further progression of CSR. In a legal context, the promotion of CSR could, inter alia, mean the following: Requiring, facilitating, enabling, incorporating and enforcing CSR.

make an important contribution to the promotion of CSR and that it could make an even better contribution if these limitations were addressed. This chapter will follow the structure of this argument: It will first discuss the limitations of private law in the promotion of CSR and then the contribution that private law makes to the promotion of CSR. The chapter will then discuss future research on CSR and the law, following the conclusion of this thesis. Finally, the chapter will provide a list of substantive recommendations for changes to English law that result from the analysis. Within the discussion of the limitations and the strengths of private law in the promotion of CSR, this chapter will also address the secondary research question to what extent English private law could contribute to the implementation of the UN Guiding Principles on Business and Human Rights into English law.<sup>1191</sup> The analysis of this question is supported by the conclusions of the substantive chapters.

## **7.2 The limitations of private law in the promotion of CSR**

First of all, it must be recognised that there are deficiencies in the promotion of CSR in English private law. CSR could be better promoted in English private law if these limitations were addressed. The following part will address the limitations of private law under three headings: First, the continuing dominance of the shareholder value theory; secondly, the patchy coverage of private law; and thirdly the weaknesses of private law remedies.

### **7.2.1 The continuing dominance of the shareholder value theory limits the promotion of CSR**

It is important to recognise that the contribution that private law makes or could make to the promotion of the CSR concept depends, to a large extent, on company law and corporate governance. Company law and corporate governance are the basis for the pursuing of objectives by companies. Within the company law/corporate governance framework, the company's board of directors decides the direction the company takes; the aims that it pursues and how it pursues those aims.

The UN Guiding Principles emphasise the role of domestic corporate laws for the state's duty to protect human rights.<sup>1192</sup> With regard to Principle 3 (b), the commentary highlights the importance of corporate laws for enabling business

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<sup>1191</sup> The UN Guiding Principles are intended to be implemented by countries and by companies. The UK government has made a political commitment to the Guiding Principles. Private law could therefore be used by the government to implement the Guiding Principles into English law.

<sup>1192</sup> Principle 3 (b) of the Guiding Principles.

respect for human rights.<sup>1193</sup> The link between corporate laws and human rights is said to remain 'poorly understood' and there is a 'lack of clarity in corporate and securities law regarding what companies and their officers are permitted, let alone required, to do regarding human rights'.<sup>1194</sup> Corporate law should provide sufficient guidance in this respect and have sufficient regard to the role of existing governance structures such as corporate boards. Guidance should advise on methods such as human rights due diligence.<sup>1195</sup> It was further added that communication from business enterprises on how they address their human rights impacts could range from informal engagement with affected stakeholders to formal public reporting.

The analysis of English company law in this thesis has shown that the promotion of CSR is restricted by the continuing fixation of English company law and corporate governance with the shareholder value doctrine. The way in which a company internalises CSR depends on the fundamental question in whose interest the company is run and also on the people who make the business decisions (within the framework of the directors' duties).<sup>1196</sup> Whilst the enlightened shareholder value doctrine has opened up the decision-making process of directors to consider other factors than purely the maximisation of shareholder value through s172 (1) CA, the doctrine continues to ultimately equate the interest of the company with the maximisation of the financial interests of shareholders.<sup>1197</sup> English company law is still firmly embedded in the shareholder value theory. Whilst directors are permitted to take stakeholder interests into account in the decision making process, they are not yet sufficiently required to do so. Against this background, it can be concluded that the criticism in the Guiding Principles that corporate laws often do not provide sufficient guidance in relation to the duty to protect human rights applies to English company law.

Moreover, the interests of stakeholders are also subordinated under the interests of shareholders in the business review in s417 CA.<sup>1198</sup> Reporting about CSR matters is a voluntary exercise for directors, as s417 (5) and (6) CA make it optional for companies to include information about environmental matters, the company's employees as well as social and community issues in the business review as long

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<sup>1193</sup> Principle 3 (b) emphasises that states should ensure that 'other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights'.

<sup>1194</sup> Commentary to Principle 3, Guiding Principles.

<sup>1195</sup> *ibid.*

<sup>1196</sup> B Horrigan, *Corporate Social Responsibility in the 21<sup>st</sup> Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar 2010) 174.

<sup>1197</sup> S Wen, 'The magnitude of shareholder value as the overriding objective in the UK: the post-crisis perspective' (2011) *Journal of International Banking Law and Regulation* 325, 336.

<sup>1198</sup> As shown in the analysis of s172 CA and s417 CA in chapter 3 on Company law and CSR.

as the company states which of those kinds of information the business review does not contain. This situation conflicts with Principle 3 (d) of the Guiding Principles which recommends that states should ‘encourage and, *where appropriate require*, companies to communicate how they address their human rights impacts’. The commentary to this principle expressly includes ‘formal public reporting’.<sup>1199</sup> It is more than questionable if the business review (s417 CA), in its current form, sufficiently implements this principle. In fact, the business review is seriously flawed in its ability to promote the socially responsible conduct of companies.<sup>1200</sup> The commentary on Principle 3 (d) suggests that a requirement for such reporting ‘can be particularly appropriate where the nature of business operations or operating contexts pose a significant risk to human rights’. A relevant example of business operations that pose a significant risk to human rights is the use of suppliers in developing countries. There are numerous reports about gross human rights abuses in the factories of such suppliers, as described in chapter 4 on supply chain contracts.<sup>1201</sup> In terms of this example, the reporting about the company’s human rights due diligence should contain information about the selection and monitoring of suppliers and, if necessary, the enforcement of the CSR commitments in supply contracts. The business review falls short of the recommendation insofar as it does not require companies to communicate how they address their human rights impact. It can be concluded that in the regulation of the business review, as with the s172 (1) CA duty, the financial interests of shareholders are given preference over the interests of the various stakeholders. Here, English law needs to be further developed, if the Guiding Principles are to be implemented adequately. The strategic report that has been proposed to replace the business review will not alter things for the better in terms of promoting CSR.<sup>1202</sup> Whilst the strategic report will explicitly require quoted companies to report on human rights issues, this reporting duty will continue to be subject to the limitation that the company must only include

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<sup>1199</sup> Commentary to Principle 3, Guiding Principles.

<sup>1200</sup> A study by Villiers and Aiyegbayo based on semi-structure interviews with key corporate governance actors such as investor relations managers and corporate governance directors from institutional investment firms confirms the conclusion of reporting agencies that the business review makes little difference to the quality of reports. See: C Villiers and O Aiyegbayo, ‘The enhanced business review: has it made corporate governance more effective?’ (2011) *JBL* 699, 700, 712.

<sup>1201</sup> For example, see the recent allegations that suppliers of the fashion brand Zara have used forced labour in Argentina: M Roper, ‘Zara probed over slave labour claims in Argentina’ *The Telegraph* (London, 4 April 2013), available at: <http://fashion.telegraph.co.uk/news-features/TMG9970846/Zara-probed-over-slave-labour-claims-in-Argentina.html> (last accessed: 13/04/2013).

<sup>1202</sup> The draft Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2013 that the government has proposed includes the requirement for companies to produce a strategic report, see BIS, *The Future of Narrative Reporting: A new structure for Narrative Reporting in the UK* (October 2012), 4, available at: <http://www.bis.gov.uk/assets/BISCore/business-law/docs/F/12-979-future-of-narrative-reporting-new-structure.pdf> (last accessed: 19/05/2013). The strategic report will continue to be subject to an exemption for small companies. This exemption will now be found in s414B. The reporting will also continue to be subject to the ‘safe harbour’ provision in s463 CA.

information about these issues 'to the extent necessary for an understanding of the development, performance or position of the company's business'. The situation would be improved if the proposed EU Directive on disclosure of nonfinancial and diversity information, with its mandatory reporting requirements on environmental, social and employee matters as well as respect for human rights, anti-corruption and bribery issues were to be introduced.<sup>1203</sup> The proposed Directive goes beyond both the business review and the proposed strategic report in terms of CSR reporting. If introduced, the Directive would increase the amount of CSR reporting, but it remains to be seen to what extent the quality of the reporting, with its adherence to the 'comply or explain' approach, would improve.

The continuing dominance of the shareholder value doctrine in English company law and corporate governance thus degrades CSR to a secondary issue in the duty to promote the success of the company for the benefit of its members as a whole in s172 (1) CA and in the business review in s417 CA.<sup>1204</sup> Without a redirection of the corporate objective in English law, CSR will not be sufficiently supported through company law and corporate governance.<sup>1205</sup> This situation might change if it is agreed that the corporate irresponsibility that has come to light in the recent financial and economic crisis would require a change to a more pluralistic understanding of the company. Similarly, it is argued in this thesis that a more diversely composed boardroom (e.g. consisting of more female directors and non-executive directors that represent the various stakeholders of the firm) could lead to more considerations of CSR in the decision-making process. A more diverse board might open up discussions in the boardroom and overcome traditional patterns of thought. Still, the directors would need to operate within the framework of the Companies Act 2006.

Consequently, despite significant overlaps of the Companies Act 2006 with CSR, the ability of private law, through company law and corporate governance, to promote CSR is currently limited. These deficiencies also limit the ability of English law to implement the UN Guiding Principles.

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<sup>1203</sup> European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' COM (2013) 207 final, available at: [http://ec.europa.eu/internal\\_market/accounting/docs/non-financial-reporting/com\\_2013\\_207\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf) (last accessed: 19/05/2013).

<sup>1204</sup> The enforcement of CSR by shareholders is addressed below in section 7.2.2.

<sup>1205</sup> See for a discussion of the relationship between a shareholder primary conception of the firm and human rights: D Millon, 'Human Rights and Delaware Corporate Law' (2012) 25 *Pac McGeorge Global Bus & Dev LJ* 173, 174.

## 7.2.2 Private law is patchy in its coverage

Private law differs significantly from public law regulation of companies because the undertaking of CSR commitments and the enforcement of CSR principles depends on the relationship between companies and private parties.

With regard to the former, CSR can only be promoted in contract law and consumer law, if companies decide to undertake CSR commitments in the first place, for example, by adopting a CSR code of conduct or by agreeing to the compliance with CSR principles in a supply chain contract. Those companies that do not incorporate CSR policies into their supply contracts cannot procure a remedy against suppliers and those companies that do not choose to sign up to a code of conduct cannot be liable for violation of CSR principles. The coverage of CSR commitments, by private law, is therefore patchy.

Moreover, the enforcement of CSR principles depends on the decision of private parties. The challenge that the enforcement of CSR principles in private law faces is that private parties need to decide whether they want to make a claim if a company has violated CSR principles. In private law, by definition, this function is not exercised by public authorities. Moreover, the enforcement of CSR commitments presupposes that there are enforcement mechanisms in place. In fact, the different substantive chapters of this thesis have shown that the enforcement of CSR principles in private law is limited in five main ways.

First, in contract law, only the parties to the contractual relationship are able to enforce contractual commitments. A particular weakness of contract law is that the enforcement of CSR obligations in supply contracts is, almost without exception, limited to the contractual parties due to the doctrine of privity of contract. This doctrine, in general, confines the contractual reach of the supply contract to the buyers and their first-tier suppliers and does not allow the contract to reach beyond that. In the context of global trade patterns, this situation is a significant limitation of the reach of the CSR policies, as many suppliers use sub-suppliers. Moreover, although third parties to the supply contract such as the supplier's employees can in theory acquire a right to enforce contractual duties against the promisor, e.g. the right to join a trade union, due to the Contracts (Rights of Third Parties) Act 1999, this right is regularly excluded by the buyer and supplier.<sup>1206</sup> The intended beneficiaries of the CSR commitments in supply contracts such as the supplier's

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<sup>1206</sup> A Burrows, 'The Contracts (Right of Third Parties) Act 1999 and its implications for commercial contracts' [2000] *L.M.C.L.Q.* 540, 545.

employees are, therefore, in practice, often barred from enforcing these commitments. It is a severe weakness in the promotion of CSR that the parties to a contract can exclude the applicability of the Contracts (Rights of Third Parties) Act 1999. In actual fact, this exclusion contradicts the aim of the Act, namely to provide third parties with a right of enforcement. The intended beneficiaries of CSR policies are left without a right of action. The possible exclusion of the rights of third parties limits the enforcement of contractual CSR obligations and hence reduces the ability of contract law to promote more socially responsible behaviour of corporations. This situation also conflicts with Principle 26 of the Guiding Principles which recommends that states should take appropriate steps to reduce legal barriers that could lead to a denial of access to justice in relation to human rights abuses by companies.

Secondly, the ability of consumers to enforce consumer protection rules which make misleading actions by companies unlawful is currently inadequate.<sup>1207</sup> The Consumer Protection from Unfair Trading Regulations (CPRs) 2008 are outside the scope of private law as they are only subject to public enforcement by the OFT and local trading standards.<sup>1208</sup> Consumers are not able to pursue private redress as they are left without a remedy in the CPRs. This situation is a missed opportunity from a CSR point of view, as CSR is brought into the scope of the CPRs due to reg 5 (3) (b) CPRs which explicitly makes the breach of a commitment in a code of conduct a misleading action, if some further requirements are satisfied. Under the current public enforcement regime of the CPRs, the intended beneficiaries of the CPRs, the consumers, are neglected. Consequently, consumers will be unable to promote the socially responsible conduct of companies through the CPRs. Although the law of misrepresentation, as private law, encompasses similar situations to the CPRs and therefore provides protection for consumers, it is a complex area of the law which is difficult to access. The fact that there has so far not been a single case for a breach of CSR commitments in a code of conduct, based on the law of misrepresentation, shows that this law does not sufficiently promote CSR. The use of consumer law as a means to enforce CSR commitments that companies have publicly made is therefore currently limited at best. Again, the current legal situation conflicts with the recommendations made in Principle 26 of the Guiding Principles.

Thirdly, the enforcement of CSR is also limited in company law and corporate governance. Where a director is in breach of one or more of his duties (e.g. the duty

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<sup>1207</sup> See chapter 5 on Consumer law and Corporate Social Responsibility.

<sup>1208</sup> This enforcement regime is subject to Part 8 of the Enterprise Act 2002. reg 26 of the CPRs makes Part 8 of the Enterprise Act 2002 applicable. Part 8 of the Enterprise Act 2002 regulates the enforcement of certain consumer legislation. It gives the OFT the lead enforcement responsibility for actions taken in the UK, s214 (1) of the Enterprise Act 2002.

to promote the success of the company for the benefit of its members as a whole<sup>1209</sup>), it is, first and foremost, down to the board to decide whether to pursue a claim against that particular director.<sup>1210</sup> The significant limitation of the enforcement of s172 (1) CA is that the intended beneficiaries, the various stakeholders enlisted in this duty, do not procure a right of action, as they do not have legal standing.<sup>1211</sup> The duty in s172 (1) CA has therefore been called 'a right without a remedy'.<sup>1212</sup> This situation limits the ability of company law to promote CSR, as s172 (1) CA overlaps with CSR. The ability to enforce the s172 CA duty is even more limited, as the test applied to the section is likely to be a subjective one (as directors must act in a way which they consider in good faith to be in the best interest of the company for the benefit of its members (i.e. the shareholders) as a whole.<sup>1213</sup> The fact that the various stakeholders who are enlisted in s172 (1) CA do not procure a remedy also conflicts with the third pillar of the Guiding Principles, which highlights the need for states to provide sufficient access to effective remedies for victims of business-related human rights abuses.

Where the company decides not to pursue a claim against a director who has breached his duty pursuant to s172 (1) CA, a shareholder can bring a derivative action pursuant to ss260 CA in respect of a cause of action vested in the company and seeking relief on behalf of the company. However, the members of the company can also decide to ratify the breach of duty, pursuant to s239 CA, in which case no derivative action can be brought. Where shareholders bring a derivative action, they face significant thresholds before they will succeed with a claim as the courts apply several tests before allowing the application for a derivative action to continue. When exercising their discretion whether or not to give the claimant permission to continue with the claim, courts seem to focus on the commercial interests of the company. Moreover, they are traditionally unwilling to second-guess business decisions. In practice, it is unlikely that claimants will succeed with derivative claims based on alleged disregard for stakeholder interests in s172 (1) CA. Similarly, despite the recent emphasis on the role of institutional investors in the ensuring of good corporate governance of companies, one can only expect little in terms of the

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<sup>1209</sup> S172 (1) CA.

<sup>1210</sup> *ibid.*

<sup>1211</sup> A Keay, 'Section 172(1) of the Companies Act 2006: an interpretation and assessment' (2007) 28 (4) *Company Lawyer* 106, 109.

<sup>1212</sup> D Fisher, 'The enlightened shareholder value – leaving stakeholders in the dark: will section 172 (1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) *ICCLR* 10, 15.

<sup>1213</sup> For example, in *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526; [2010] B.C.C. 420 the court held that it was not in the best position to make judgements about the weight of the considerations in s172 CA except in very clear cases as these are commercial issues and the director's subjective judgements would prevail in these circumstances.



promotion of CSR. The UK Stewardship Code contains only little recognition of social and environmental matters. It rather focusses on the monitoring of the investee companies than the pursuit of CSR goals. The enforcement of CSR principles in company law is therefore severely limited.

Fourthly, in tort law, although several causes of action overlap with CSR principles and therefore, in principal, apply to all companies, tort victims still need to decide if they want to make a claim for the tort. In particular, the ability of tort law to promote the socially responsible conduct of companies is restricted due to the approach to corporate group liability in English law, which treats all companies in a corporate group as separate legal entities. The use of corporate group structures enables parent companies to reduce or even to avoid liability, as confirmed in *Adams v Cape Industries plc*<sup>1214</sup>. This situation is particular unfair for involuntary tort creditors of undercapitalised subsidiaries of a parent company, e.g. tort creditors who have suffered from an abuse of their human rights. If the UK government seeks to implement the Guiding Principles adequately, that would be an opportunity for the legislator to re-consider the approach towards liability in corporate groups. The current approach towards liability in corporate groups in English law does not provide effective judicial mechanisms, as tort creditors of (undercapitalised) subsidiaries may not be able to be successful with their claim against a subsidiary irrespective of the financial status of the parent company, even where the parent company is the sole shareholder of the subsidiary and where both the parent and the subsidiary company have the same directors. This situation conflicts with the third pillar of the Guiding Principles, which, as we have already seen, emphasises the need to provide effective remedies for victims of business-related human rights abuses. In particular, the commentary to Principle 26 explicitly refers to the example of the avoidance of appropriate accountability due to the way in which legal responsibility is attributed among group members of a corporate group under domestic criminal and civil laws.<sup>1215</sup>

Fifthly, as the enforcement of private law depends on private parties, it is important that they have access to effective civil litigation mechanisms. The cost and time involved is often a barrier for private parties to bring civil litigation. The chapter on tort law has shown that recent proposals by the government about changes to the system of funding cases might make it less likely that private claimants will bring an

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<sup>1214</sup> *Adams v Cape Industries plc* [1990] BCLC 479, 543.

<sup>1215</sup> Commentary, Principle 26, Guiding Principles.

action at all.<sup>1216</sup> The planned changes to the conditional fee agreement system (the so-called “no win-no fee” system) by the government will make it less attractive for solicitors to accept cases where the claimant cannot afford the initial cost of litigation.<sup>1217</sup> This situation is particularly dissatisfying, given that the company usually has far better means than the private individual bringing the claim. The proposed changes are likely to reduce the number of claims brought in tort against companies.<sup>1218</sup> The changes will consequently conflict with the above-noted recommendation of Principle 26 of the Guiding Principles that states should provide effective remedies against business-related human rights abuses (third pillar). The effectiveness of civil litigation is also limited by the rather restrictive use of multi-party actions in English law.<sup>1219</sup> Group litigation orders are the main approach of the English system’s treatment of multiparty litigation (they are an ‘opt-in’ system). Due to the various procedural requirements of group litigation orders and the need for each individual to ‘opt-in’, the restricted use of group litigation further limits the ability of private law to promote the socially responsible conduct of companies. This situation, too, is a legal barrier and therefore conflicts with Principle 26 of the Guiding Principles. The commentary to this principle explicitly refers to the example of ‘inadequate options for aggregating claims or enabling representative action (such as class action and other collective action proceedings)’.<sup>1220</sup>

In conclusion, the promotion of the socially responsible conduct of companies in English private law is patchy in its coverage. Companies need to agree on the incorporation of CSR obligations into contracts or they must decide to adopt CSR principles. Moreover, the enforcement of CSR commitments depends on the decision of private parties. The enforcement mechanisms for CSR policies in the substantive areas of private law analysed in this chapter are currently limited at best.

### **7.2.3 Weaknesses of private law remedies**

Although the strength of private law is that it enables private parties to enforce CSR commitments, the remedies that are awarded in private law claims are, first and foremost, intended to promote the interests of the claimant. Hence, the remedies in contract are repudiation and damages, in tort the remedies are primarily damages

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<sup>1216</sup> Ministry of Justice, *Civil justice reforms*, available at: <http://www.justice.gov.uk/civil-justice-reforms> (last accessed: 10/12/2012).

<sup>1217</sup> R Meeran, ‘Multinationals will profit from the government’s civil litigation shakeup’, *The Guardian*, 24<sup>th</sup> May 2011, available at: <http://www.guardian.co.uk/commentisfree/libertycentral/2011/may/24/civil-litigation-multinationals> (last accessed: 05/03/2013).

<sup>1218</sup> *Ibid.*

<sup>1219</sup> See for an introduction into the topic: N Andrews, ‘Multi-Party Actions and Complex Litigation in England’ (2012) 23 *E.B.L.Rev.*, 1.

<sup>1220</sup> Commentary, Principle 26, Guiding Principle.

with some injunctions and in consumer law (through the law of misrepresentation) the remedies are the right to rescind the contract and damages. In company law and corporate governance, if a claim for breach of directors' duties is successful, then the remedies are the same civil consequences under the Companies Act 2006 as would apply if the corresponding common law rule or equitable principle applied.<sup>1221</sup> Those remedies are claims for losses and claims for profit and they are only awarded to the company.<sup>1222</sup> They would therefore not promote the interests of the stakeholders affected by a breach of s172 (1) CA. The prevalent remedy in private law actions is therefore damages which are awarded in order to account for the losses of the claimant. The underlying aim is to put the claimant back into the position, in which he would have been, had the event giving rise to the claim not occurred.

Whilst these remedies might be appropriate for the claimant, they are not necessarily the most effective means for the promotion of CSR. In particular, these remedies do not directly cover the interests of the stakeholders who have suffered from the violation of CSR principles. This situation is particularly evident in tort law which is closely connected to the protection of personal interests such as health and property. The causes of action in tort are bound to personal interests. Consequently, the pollution of the environment is only addressed by tort law to the extent that the claimant has suffered harm to his personal interests such as health or property. The environment is therefore not protected per se, but only indirectly as a proprietary interest of a person. The compensatory nature of remedies in tort law somewhat limits the promotion of CSR. It is a weakness of the current tort system that exemplary damages, which could deter companies from irresponsible conduct, are only rarely awarded. The restricted use of injunctions which are an equitable remedy further limits the ability of tort law to promote CSR, as an injunction would be an appropriate remedy in many situations where what is desired is to stop the company from continuing with the violation of CSR principles. Injunctions would prohibit companies from continuing with acts that violate CSR principles.

Consequently, despite the ability of private law to provide remedies for the enforcement of CSR commitments, the remedies themselves have deficiencies in their ability to promote the socially responsible conduct of companies. In particular, the focus on compensatory damages restricts the ability to promote CSR.

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<sup>1221</sup> S178 (1) CA 2006.

<sup>1222</sup> B Hannigan, *Company Law* (3<sup>rd</sup> ed., OUP 2012) para 13-8.

### 7.3 The ways in which private law plays an important part in the promotion of CSR

Notwithstanding its limitations, the thesis has shown that English private law does play a significant role in the promotion of CSR. The following part will first address the overlap between CSR and private law before looking at the mechanisms that private law provides for the incorporation and enforcement of CSR. Finally, it addresses the contribution of private law to hybrid regulatory systems of CSR.

#### 7.3.1 CSR is, at least in part, law

First of all, the analysis in the substantive chapters has shown that CSR is, at least in part, law. This finding contradicts the common understanding of CSR as being 'above and beyond the law' which is often the position adopted by business organisations.<sup>1223</sup> Buhmann notes that this understanding of CSR 'has led to an idea that CSR and law are distinct'.<sup>1224</sup> In fact, this thesis has shown that there are direct overlaps between CSR and provisions in company law and causes of action in tort law with CSR whereas contract law and consumer law rather provide means for the incorporation and enforcement of CSR commitments, e.g. in supply chain contracts. This section will therefore address company law and tort law due to their more direct overlap with CSR.

Company law and corporate governance, within the framework of the enlightened shareholder value doctrine, at least in theory have potential to promote the socially responsible conduct of companies.<sup>1225</sup> Company law and corporate governance overlap with CSR in terms of the duty to promote the success of the company for the benefit of its members as a whole<sup>1226</sup> and the business review.<sup>1227</sup> There is a strong correlation between the list of factors in the duty for directors to promote the success of the company in s172 (1) CA and CSR, as directors are required to take various factors into account when discharging this duty, e.g. the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, as well as the impact of the company's operation on the

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<sup>1223</sup> See The Confederation of Business Industry (CBI), available at: <http://www.cbi.org.uk/ndbs/content.nsS/802737AED3E3420580256706005390AE/9D502144AC9F644380256F58005BD16C> (last accessed 03/10/2012); Department for Business, Innovation and Skills, <http://www.bis.gov.uk/policies/business-sectors/low-carbon-business-opportunities/sustainable-development/corporate-responsibility> (last accessed 03/10/2011).

<sup>1224</sup> K Buhmann, 'Integrating human rights in emerging regulation of corporate social responsibility: the EU case' (2011) 7 *International Journal of Law in Context* 139, 140.

<sup>1225</sup> See chapter 3 on Company law and Corporate Social Responsibility.

<sup>1226</sup> S172 (1) CA.

<sup>1227</sup> S417 CA; see also: J L Yap, 'Considering the enlightened shareholder value principle' (2010) *Company Lawyer* 35, 37; J K S Ho, 'Is section 172 of the Companies Act 2006 the guidance for CSR?' (2010) *Company Lawyer* 207, 210.

community and the environment. The stakeholders enlisted in s172 (1) CA are coterminous with the groups encompassed by the CSR definition adopted in this thesis.<sup>1228</sup> One could therefore argue that CSR is legally embodied through s172 (1) CA. Moreover, CSR is further embedded in the Companies Act through the businesses review in s417 CA which requires directors to report on how they have performed their duty under s172 (1) CA. This reporting duty in s417 CA creates transparency on the discharge of the s172 duty and therefore enables others to inform themselves if and, if so, how the interests of the stakeholders enlisted in s172 (1) CA were taken into account in decisions of the directors.<sup>1229</sup>

There is also an overlap between several causes of action in tort law and the concept of CSR, for example, negligence, private nuisance, public nuisance, breach of a statutory duty and breach of strict product liability provisions. Tort law overlaps with CSR where torts encompass violations of CSR principles. The hypothetical scenario used in the chapter on tort law and CSR has shown how companies can be liable in tort to their employees and the local community for tortious acts which violate CSR principles, such as the breach of health and safety standards and environmental. Tort law therefore provides a tool to promote the socially responsible conduct of companies.

In summary, CSR and English private law overlap in a number of ways. CSR is, at least in part, law, despite continuing claims of the opposite. Claims that CSR is *purely* voluntary and beyond the law are, consequently, a superficial and an inaccurate account of the legal situation pertaining to CSR.

### **7.3.2 Private law provides mechanisms to incorporate CSR**

Through contract law, private law also provides a mechanism for incorporating CSR commitments into contracts and thus giving legal effect to these commitments.<sup>1230</sup> Multinational companies increasingly incorporate CSR codes of conduct into their contracts with their suppliers.<sup>1231</sup> They do so by using three different mechanisms through which CSR becomes part of the supply contracts: First, terms and conditions incorporated into the buyer's purchase order, secondly expressly

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<sup>1228</sup> K Campbell and D Vick, 'Disclosure Law and the market for corporate social responsibility' in D McBarnet, A Voiculescu and T Campbell (eds), *The new corporate accountability: Corporate social responsibility and the law* (CUP 2007) 242.

<sup>1229</sup> As indicated in the analysis of the business review, companies can avoid reporting on CSR matters, if they state in the business review that it does not contain information about environmental matters, the company's employees and social and community issues.

<sup>1230</sup> See chapter 4 on Contract law and Corporate Social Responsibility.

<sup>1231</sup> M Andersen and T Skjoett-Larsen, 'Corporate Social Responsibility in global supply chains' (2009) 14 *Supply Chain Management: An International Journal* 75, 77.

negotiated contracts and thirdly inclusion of the CSR policy into the tenderer process. In practice, the most common form of the three different mechanisms is the incorporation of the buyer's terms and conditions, which contain CSR provisions into the contract between the buyer and the supplier.<sup>1232</sup>

Contract law therefore differs from company law and tort law insofar as there is no contract law rule per se which overlaps with CSR; rather contract law provides a tool for private parties to incorporate CSR commitments into their legal relationship. Contract law rules enable the buyer to impose duties on the supplier to comply with CSR commitments, such as the obligation not to commit bribery, not to use child or forced labour and to allow its employees to be member of a trade union. Contract law is therefore able to make CSR codes of conduct, which are commonly perceived of as being voluntary, contractually enforceable. Therefore, through the use of contract law, CSR commitments which are voluntarily undertaken by Western-based multinational companies, often due to public pressure, can become contractual terms and are consequently enforceable against the supplier. Contract law therefore provides tools to give legal effect to CSR commitments, if parties choose to incorporate these commitments into their contract. Through contract law, CSR obligations can be imposed on suppliers in different countries of the world, particularly in those countries which are known to have a weak legal system or a weak law enforcement mechanism. This extended territorial reach of contractual CSR commitments is a strength of private law.

### **7.3.3 Private law provides means to enforce CSR commitments**

Private law also provides persons with remedies for breach of their rights.<sup>1233</sup> The substantive chapters of this thesis have shown that private law is a tool to enforce CSR commitments. A distinction can be made between the ability of companies to enforce CSR commitments and the ability of private individuals to do so.

First of all, despite the criticisms of the enforcement of s172 (1) CA discussed above, this duty with its significant overlap with CSR can be enforced by the board of directors or, alternatively, by shareholders through a derivative action. English private law, through company law, therefore, provides a tool to enforce this duty which embodies CSR. Directors who have breached this duty are potentially accountable for the loss that the company has suffered as a consequence of the

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<sup>1232</sup> See chapter 4 on Contract law and Corporate Social Responsibility for an analysis of the different ways how companies incorporate CSR commitments into their supply chain contracts.

<sup>1233</sup> See D Nolan and A Robertson, 'Rights and Private Law' in D Nolan and A Robertson, *Rights and Private Law* (Hart Publishing 2011) 18.

director's conduct. Secondly, the strength of contract law is that it enables the buyer to incorporate CSR obligations into the supply contract, and hence to create enforceable contractual terms. That way, duties of socially responsible behaviour can be imposed on the supplier in private contracts and these duties can be enforced by the buyer. Where the CSR commitments are conditions or, in case of innominate terms, where breaches are repudiatory, the buyer will procure a right to repudiate the contract. This right is a powerful tool for buyers, as the supplier would then lose the contract as a consequence of his violation of contractual CSR obligation. Thirdly, although the enforcement of consumer law provisions that make it unlawful to violate publicly announced commitments in a code of conduct is currently only to a very limited extent subject to private enforcement (i.e. the law of misrepresentation), there is potential for a significant improvement if the government were to introduce a private remedy for consumers, as recommended by the Law Commission.<sup>1234</sup> Consumers could, consequently, gain a right to terminate the contract where companies fall short of their publicly announced CSR commitments. As companies commonly portray their brands as being socially responsible in order to positively influence the perception that consumers have of them<sup>1235</sup>, the right to rescission would constitute a deterrent for companies not to violate the CSR commitments that they have made to the public. Fourthly, tort law provides causes of action for tort victims who suffer from a tort which also violates CSR principles.<sup>1236</sup> Tort law provides the stakeholders who are the intended beneficiaries of CSR, such as the company's employees, with a remedy. Tort law is therefore a particularly effective means of enforcing the socially responsible conduct of companies.

On the whole, it is a strength of private law that it enables private parties to enforce CSR commitments. In all four areas of private law analysed in this thesis, private parties procure a remedy where a company has violated CSR commitments. The prevalent remedy in private law actions is damages. Despite its limitations in the promotion of CSR, addressed above, damages are nevertheless a remedy that accounts for the loss that a private party has suffered from a violation of CSR commitments. Whilst the cause of action in company law and contract law is

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<sup>1234</sup> The Law Commission published a report in March 2012 with suggestions about the reform of consumer redress for misleading and aggressive practices which is now subject to a review by the government. The Law Commission and The Scottish Law Commission, *Consumer Redress For Misleading And Aggressive Practices*, (Law Com No 332 / Scot Law No 226, March 2012), available at: [http://lawcommission.justice.gov.uk/docs/lc332\\_consumer\\_redress.pdf](http://lawcommission.justice.gov.uk/docs/lc332_consumer_redress.pdf) (last accessed: 13/12/2012). The Law Commission's recommendations propose the introduction of a new statutory right of redress for a consumer against a trader in private law for consumers who have suffered from misleading and aggressive trade practices.

<sup>1235</sup> M Polonsky and C Jevons, 'Global branding and strategic CSR: an overview of three types of complexity' (2009) 26 (3) *International Marketing Review* 327, 328.

<sup>1236</sup> See the case studies in chapter 6 on tort law and Corporate Social Responsibility.

primarily vested in companies, tort law (and potentially also consumer law) provides private individuals, who are the intended beneficiaries of CSR commitments, with means to enforce CSR principles. Private law remedies are therefore an important instrument for the promotion of the socially responsible conduct of companies.

#### **7.3.4 Private law contributes to hybrid regulatory approaches to CSR**

A further way in which private law plays an important role in the promotion of CSR is its contribution to hybrid regulatory systems.<sup>1237</sup> Based on the conclusions in the previous sections (i.e. CSR is, at least in part, law; private law provides means to incorporate and to enforce CSR principles), it can be argued that private law is one part of a regulatory system in which private law, public law, soft law standards developed by private actors as well as international organisations and private regulation by and between companies, all interact with each other, in order to promote CSR.

Within this integrated, hybrid regulatory system, the various areas of private law analysed in this thesis serve different functions at various levels. First, company law and corporate governance, within the framework of the enlightened shareholder value theory, set the foundation for the company's CSR engagement through directors' duties and expectations in disclosure rules. Secondly, through contract law, private law provides a mechanism for companies to incorporate and to enforce CSR commitments (which can be based on soft law standards developed at the international or national level by international organisations or non-governmental organisations). The wide-spread incorporation of the same international CSR standards into supply contracts could create a level playing field between companies. Thirdly, if the recommendations of the Law Commission concerning the introduction of a private remedy in consumer law were implemented, then private law would provide a further tool of enforcement for consumers. They could ensure that companies comply with their publicly adopted CSR commitments. Fourthly, tort law imposes civil liability within the system for conduct of companies that violates CSR principles.

One overall contribution of this thesis is to show that the effectiveness of this regulatory system in promoting CSR can be enhanced by regulation through public and criminal law of companies in their home state, in combination with national private law. The substantive chapters have shown that bribery as well as the use of

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<sup>1237</sup> See for a discussion of the term 'hybrid' in relation to regulation: M Vrieling, C van Montfort and M Bokhorst, 'Codes as hybrid regulation' in D Levi-Faur (ed), *Handbook On The Politics Of Regulation* (Edward Elgar 2011) para 35.5.2.



forced labour and child labour are the aspects of the CSR agenda which are worded in the strictest way in the CSR codes of conduct and in CSR commitments included into supply chain contracts. Commitments about the protection of the environment, in contrast, are commonly phrased in a more aspirational and less definite way. While the use of child and forced labour is of particular reputational concern for companies, bribery is now covered in a wide-reaching domestic sanction system in English law since the introduction of the Bribery Act 2010. This Act makes a company potentially liable in criminal law for the failure to prevent bribery by a person associated with the company, including the company's employees, agents or subsidiaries.<sup>1238</sup> Although not English law, an example where companies are required to address certain CSR issues in their supply chain is the California Supply Chain Transparency Act which requires disclosure about the way a company deals with slavery and human trafficking in its supply chain.<sup>1239</sup> This example also demonstrates that the home state of multinational companies can have an impact on the way companies address CSR issues, as it requires retail sellers and manufacturers to disclose their efforts to combat slavery and human trafficking and to eliminate it from their direct supply chains.<sup>1240</sup> It is to be expected that the proposed EU Directive on the disclosure of nonfinancial and diversity information, once introduced, would enhance the disclosure of the policies that companies have on issues such as human rights, the environment and bribery.

The hierarchy that currently exists in the way different aspects of the CSR agenda are dealt with in codes of conduct and/or commitments in supply contracts therefore seems to be influenced by both reputational and liability (especially criminal liability) risks. The different treatment of the various CSR aspects by companies is interesting in so far as the signing up to or drafting of CSR codes of conduct, as well as the incorporation of CSR commitments into supply contracts, is voluntary in the first place (notwithstanding their subsequent legal effects once adopted by a company or incorporated into a contract). So, the companies themselves decide how strictly they phrase these commitments. Particularly, the strict manner in which companies deal with bribery in their business relationships seems to be positively influenced by liability risks resulting from the Bribery Act 2010. It is therefore argued here that the way companies deal with CSR issues within their company and vis-à-vis their suppliers can be enhanced where these CSR principles are supported by domestic sanctions, especially in criminal law. The Bribery Act 2010 shows that it is

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<sup>1238</sup> SS7, 8 Bribery Act 2010.

<sup>1239</sup> The Act is available at: [http://leginfo.ca.gov/pub/09-10/bill/sen/sb\\_0651-0700/sb\\_657\\_bill\\_20100930\\_chaptered.html](http://leginfo.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.html) (last accessed 14/12/2012).

<sup>1240</sup> S3 of the California Transparency in Supply Chains Act of 2010.

possible to establish liability in the home state of multinational companies for the conduct of their employees, agents or suppliers. The voluntary use of CSR commitments within a hybrid regulatory system of CSR can therefore be improved, where it is required by domestic law and where violations of CSR commitments are punishable by sanctions at the domestic level. The advantage of regulatory measures such as the Bribery Act 2010 or the California Supply Chain Transparency Act is also that they ensure that all companies need to address bribery and/or the use of forced labour and that, consequently, loopholes are closed. Stronger EU disclosure laws about CSR policies (despite their 'comply or explain' approach) are therefore likely to positively influence the way in which companies engage with CSR through the voluntary adoption of a code of conduct and the incorporation of CSR policies into supply chain contracts. The likely consequence of such domestic requirements and/or sanctions is that they initiate the undertaking of CSR commitments by companies as well as promoting compliance. The interaction between domestic sanctions and private law is therefore likely to enable private law to better promote CSR.

The particular advantage of private law within such a hybrid regulatory system is that it enables CSR commitments to reach beyond the territory of the home state of the company (i.e. England or Wales here). For example, the incorporation of CSR commitments into supply chain contracts can bind contractual partners across the world. English private law can therefore cross national boundaries and expand the reach of CSR commitments beyond the English territory. Supply chain contracts can consequently be used as a tool to bind companies which are based in countries with lower standards of legal protection and/or law enforcement to comply with certain CSR commitments. Contract law can interact with soft law CSR standards, thereby utilising standards developed by private actors or international organisations and providing the means to incorporate and to enforce these. Once the private remedy for consumers is introduced into consumer law, it, too, will enable consumers to enforce compliance by companies with their publicly declared CSR commitments in a more accessible way than currently possible under the law of misrepresentation. Depending on the way in which CSR commitments are phrased, their enforcement through consumer law could also affect the conduct of English companies in other countries or the way their agents and suppliers act. This situation would again lead to an interaction between voluntarily adopted CSR commitments with private law, with the latter enforcing the former.

These different regulatory tools together promote the socially responsible conduct of companies. Private law and public law, soft law and hard law are not conflicting tools in the promotion of CSR; they are rather complementing elements in this hybrid system of regulation. The important point here is that the thesis has shown that private law plays a key role in this hybrid regulatory system.

#### **7.4 Limitations of this research and scope for subsequent research**

The analysis in this thesis has brought to light several questions about the relationship between CSR and law. This section will give an overview of some of these areas as well as outline the scope for subsequent research, building on the conclusions of this thesis.

First of all, it was beyond the scope of this thesis with its substantial doctrinal analysis to sufficiently engage with socio-legal theoretical frameworks, such as reflexive governance or meta-regulation, as approaches to the understanding of the regulatory environment of CSR and private law.<sup>1241</sup> A different thesis could have addressed the various ways in which mandatory duties, imposed by the state, interact with the voluntary undertaking of CSR commitments by private actors from these socio-legal perspectives. These approaches could be utilised for the discussion about the further ways of regulating CSR (labelled as ‘hybrid approaches’ here) in order to review the possible effects of CSR regulation on the conduct of companies. The strengths of these theoretical frameworks is that, for example, the theory of reflexive governance is a process-oriented legal theory which looks at the learning and exchange between different social subsystems.<sup>1242</sup> The various layers of CSR regulation (e.g. private law, international law, private regulation) provide a suitable tool for such a process-oriented understanding. Equally, a socio-legal study based on empirical data, such as interviews with company directors, or indeed consumers, could have revealed how CSR works in practice, and whether legal frameworks affect behaviour even without actual enforcement through legal remedies. Such approaches would complement the doctrinal perspective taken here. The strength of the doctrinal approach used here is that, with its systematic

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<sup>1241</sup> See C Scott, ‘Reflexive governance, meta-regulation and corporate social responsibility: the “Heineken effect”’ in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2008) 170; C Parker, ‘Meta-regulation: Legal accountability for corporate social responsibility’ in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007) 207; J Bomhoff and A Meuwese, ‘The Meta-regulation of Transnational Private Regulation’, in C Scott, F Cafaggi and L Senden (eds), *The Challenges of Transnational Private Regulation: Conceptual and Constitutional Debates* (Wiley-Blackwell 2011) 138.

<sup>1242</sup> C Scott, ‘Reflexive governance, meta-regulation and corporate social responsibility: the “Heineken effect”’ in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility*, (Edward Elgar 2008) 174.

analysis, exposition of and commentary on cases and statutes as well as secondary sources such as academic literature, Law Commission papers and CSR reports of companies, it provided a suitable method to answer the underlying primary research question, i.e. to what extent English private law *already* promotes Corporate Social Responsibility. The doctrinal method enabled the research to reveal the significant role that private law plays in the promotion of CSR which has so far not been sufficiently reflected in the legal literature. Moreover, on the basis of this method, it was also possible to identify the weaknesses and strengths of private law, at least in principle, in the promotion of CSR. Overall, by using a doctrinal method, it was possible to conduct a detailed analysis of the legal aspects of CSR which are the focus of this thesis.

Secondly, the thesis incidentally contributes to the broader debate on the question of the extent to which private law has a regulatory function.<sup>1243</sup> The regulatory function of private law is understood as the ability to address market failures.<sup>1244</sup> The way in which private law promotes CSR raises the question of whether the traditional understanding of private law as purely regulating the legal relationships between private individuals, without pursuing any goals for the benefit of wider society, is still tenable.<sup>1245</sup> In the promotion of CSR, private law does not purely facilitate the use of individual rights between private parties, but it also de facto pursues public policy goals. It arguably now directly advances the common good through the imposition of the duty in s172 (1) CA to promote the success of the company for the benefit of its members as a whole, as this duty requires directors to take into account in their decision-making process the interests of various stakeholders. By providing mechanisms in contract law for the incorporation and enforcement of CSR commitments by private actors, private law indirectly also promotes the general public interest. Moreover, by creating liability for violations of CSR principles, tort law also pursues the benefit of wider society. It can therefore be argued that, with its contribution to the promotion of the socially responsible conduct of companies, private law holds a regulatory function. It has been contended in the debate about the goals of private law that, with its combination of individual rights and policy considerations, private law changes its nature to a mixture of corrective

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<sup>1243</sup> See for the notion that private law can have a regulatory function: H Collins, *Regulating Contracts* (OUP 1999) 56 – 93.

<sup>1244</sup> F Cafaggi and H Muir-Watt, 'Introduction' in F Cafaggi and H Muir-Watt, *Making European Private Law Governance Design* (Edward Elgar 2008) 2.

<sup>1245</sup> See for example: S Hedley, 'Looking Outward or Looking Inward? Obligations Scholarship in the Early 21<sup>st</sup> Century' in A Robertson and T H Wu (eds), *The Goals of Private Law* (Hart Publishing 2009) 193; S Hedley, 'Is private law meaningless?' (2011) 64 (1) *Current Legal Problems* 1.

justice and distributive justice.<sup>1246</sup> The ways in which private law interacts with CSR are a prime example of this changing nature of private law. Whilst private law continues to provide a tool for private individuals to seek compensation for losses which they have suffered (e.g. for torts and breach of contract), it is directly and indirectly also a means to promote social policy goals through the various ways in which it requires, enables or enforces the socially responsible conduct of companies. The hybrid system of CSR regulation outlined above illustrates the changing nature of private law, as the system combines the traditional regulatory use of private law within private legal relationships with its ability to promote the public good. In future research, the implications of this regulatory system of CSR can be further explored in order to engage with those who deny a regulatory function of private law.

Thirdly, because of its jurisdictional focus on English private law, it was not possible to fully explore the various private international law issues that this thesis raises. By its nature, the concept of Corporate Social Responsibility addresses the conduct of companies worldwide. In particular, it focusses on the impact companies from the North / West have on people and the environment in the southern hemisphere of the world, either directly, through their subsidiaries or their suppliers. The focus on English private law in this thesis therefore raises the question to what extent the four areas of English private law addressed in this thesis are applicable to the conduct of English multinational companies in countries of the developing world, either directly or through their subsidiaries and / or suppliers. These issues were briefly addressed in each chapter; however, it was not possible to fully explore the various circumstances that might determine the question in which English law is applicable, for example, in relation to tort law.<sup>1247</sup> A detailed analysis of all the circumstances when English law is applicable in relation to violations of CSR principles that occur outside the territory of England and Wales is thus a matter for subsequent research. This analysis would contribute to the discussion as to whether the current private international law framework, for instance in relation to torts committed abroad, needs to be changed in order to better promote the socially responsible conduct of companies.<sup>1248</sup>

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<sup>1246</sup> H Collins, 'Governance implications for the European Union of the changing character of private law' in F Cafaggi and H Muir-Watt (eds), *Making European Private Law Governance Design* (Edward Elgar 2008) 278.

<sup>1247</sup> See for a brief introduction into the topic: O Amao, *Corporate Social Responsibility, Human Rights and the Law: Multinational corporations in developing countries* (Routledge 2011) 268–273.

<sup>1248</sup> See for the discussion about the extraterritorial application of tort law for example: R Meeran, 'Tort Litigation against Multinational Corporations for Violations of Human Rights: An Overview of the Position Outside the United States' (2011) 3 (1) *City University of Hong Kong Law Review* 1–41.

Fourthly, in this thesis, the analysis of the possible implementation of the UN Guiding Principles into English law could only address private law. However, the UK government will necessarily need to review both public and private law when it develops its national plan on the implementation of the Guiding Principles into domestic English law. The topic of the implementation of the Guiding Principles into English law deserves further exploration in more detail in subsequent research. However, due to the overlap between the research underlying this thesis and some of the points raised by John Ruggie in the Guiding Principles the thesis included a preliminary analysis of the links between the two.

Finally, the CSR concept is particularly prominent in the USA and the UK where the traditional understanding of company law and corporate governance is firmly embedded in the shareholder value doctrine. In comparison, the debate about CSR is still relatively recent in Germany with its more stakeholder value (pluralist) conception of company law.<sup>1249</sup> This observation raises two interesting questions for future comparative research, particularly given the relationship between corporate theory and the approach to CSR that was shown in this thesis: First, the approaches to CSR in legal systems with different underlying corporate doctrines should be compared. Secondly, at a more foundational level, it should be examined to what extent the underlying approach to company law and corporate governance in different legal systems impacts on the need/public pressure for CSR commitments. Is there, perhaps, less of a need for companies following a stakeholder value approach to publicly commit themselves to CSR principles, as these companies already pursue a more socially responsible agenda by their nature? Are discussions at board level perhaps already more inclusive and pluralist in companies which are subject to the German system of co-determination, where employee representatives constitute up to 50% of the members of the supervisory board of companies? This future comparative research will provide arguments for the debate about the corporate theory in English law and the question of whether the theoretical framing of the company in English law could change towards a more pluralist conception.

### **7.5 Substantive recommendations for changes to English private law to improve its contribution to the promotion of CSR**

This thesis has shown that, despite its limitations, English private law already makes an important contribution to the promotion of CSR. However, if it were to make an even better contribution then some changes would be needed to the areas of private

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<sup>1249</sup> See for a comparison of the different approaches to shareholder value: A Gamble and G Kelly, 'Shareholder Value and the Stakeholder Debate in the UK' (2001) 9 *Corporate Governance* 110, 113.

law analysed in the substantive chapters. Based on the analysis of the extent to which CSR is already promoted in English private law, the substantive chapters also discussed suggestions as to how the respective areas of law could be further developed in order to better promote CSR. The thesis will conclude with a list of substantive recommendations for changes to English private law that result from the analysis. It is not possible to fully develop the recommendations, as that is rather a matter for future research, based on this thesis.

The substantive recommendations for changes to English private law are:

- The fundamental limitation of English private law is the fact that the enlightened shareholder value theory is still firmly embedded in the goal of maximising shareholder value. It is unlikely that the situation will improve much without a redirection of the corporate objective in English law to a more pluralistic understanding of the firm. It was beyond the scope of this thesis to sufficiently engage with the question whether or not the underlying corporate doctrine in English company law should change. However, it is submitted here that the analysis has shown that the continued prioritisation of shareholder value in the enlightened shareholder value model severely restricts the promotion of CSR. Therefore, proposals about changes to English private law for a greater promotion of CSR will necessarily have to engage with the issue of the underlying corporate doctrine. A change to a more pluralistic understanding of the firm would inevitably have ramifications for the framing of directors' duties in a way that directors have more discretion to recognise the interests of stakeholders.
- The business review and its proposed replacement, the strategic report, leave too much discretion for directors to decide if and, if so, to what extent they report on CSR matters. The proposed EU Directive on the disclosure of nonfinancial and diversity information, if introduced, is likely to improve the *amount* of reporting on CSR. Its introduction is therefore important. However, the potential that the Directive has for promoting CSR is likely to be restricted by its adherence to a 'comply or explain' approach. Instead, the reporting duties about the CSR matters contained in the directive should be made compulsory and a greater focus on *quality* of reporting should be implemented.
- The thesis argues that it is important to focus on the board in order to better promote CSR. Non-executive directors would need to better exercise their function to monitor and to challenge decisions in the boardroom. Moreover, more

diverse boards consisting of directors that better represent the companies' stakeholders are likely to challenge traditional patterns of thought (often referred to as 'group think') and to move the decision-making more towards including CSR considerations.

- The ability for contractual parties to exclude the applicability of the Contracts (Rights of Third Parties) Act 1999 should be abolished. Third parties who are expressly identified in contractual clauses in supply contracts as the intended beneficiaries of CSR obligations, for example the supplier's employees, should have a right to enforce these CSR obligations, such as the right to join a trade union. If the contractual parties incorporate CSR obligations benefitting third parties, they should expect these duties to be enforced by these third parties.
- In consumer law, the government should follow the recommendation made by the Law Commission to introduce a private remedy for consumers. This remedy would enable consumers to enforce compliance of companies with their publicly declared CSR commitments.
- Whilst the proposed private remedy for consumers is positive from a CSR point of view, two proposed changes to the law should not be introduced, however, as they are likely to restrict the enhancement of greater CSR. First, the proposed short definition of misleading actions would exclude the current explicit mentioning of breaches of codes of conduct in the definition used in reg 5 Consumer Protection from Unfair Trading Regulations 2008. The proposal to use a shorter definition is a reason for concern from a CSR point of view, given that breaches of codes of conduct have so far not been followed up in practice, so consumers are unlikely to be fully aware that such behaviour would continue to fall under the new definition. It is therefore important to keep the existing definition of misleading actions in reg 5 Consumer Protection from Unfair Trading Regulations 2008. Secondly, the fact that the new Act would require the formation of a contract in the first place for consumers to gain a remedy is a further aspect that will reduce the number of potential claims. The sole fact that a company does not meet its CSR commitments in codes of conduct should be sufficient for an action in consumer law.
- Tort law could better promote CSR if a more integrated approach to liability within corporate groups were introduced where parent companies could be made liable



for tort liabilities of their subsidiaries. This change would ensure that companies can no longer avoid liability by setting up undercapitalised subsidiaries to the detriment of tort creditors.

- Access to civil litigation for tort victims must be facilitated. The changes to the funding of civil litigation and the restricted use of class actions in personal injury claims limit the promotion of CSR in tort law. Therefore, it is necessary that the demise of conditional fee agreements is reversed and that the provision of class action is expanded.
  
- Finally, the remedies available in private law for violations of CSR are deficient in their ability to promote the socially responsible conduct of companies. The remedies that are awarded for violations of CSR need to take better account of CSR. Consumers would be able to promote CSR much more meaningfully, if they could enforce compliance with CSR commitments through injunctions instead of terminating their contract with the company under the regime recommended by the Law Commission. The buyers in supply contracts would be able to better enforce CSR if they could more easily procure the remedy of specific performance. This remedy would compel the obligor to perform the agreed obligation. However, the award of this remedy is within the discretion of the courts as it is an equitable remedy. It is therefore only rarely granted. The situation is similar for tort victims. Whilst they are compensated for the damages that they suffered due to the tort, it would be more beneficial for the promotion of CSR if injunctions (to stop the tort or to undo the harm) and exemplary damages (to punish the tortfeasor) were more frequently awarded.



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