

REDEFINING THE CORPORATION

How could new EU Corporate liability Rules help ?

DISCUSSION PAPER

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TABLE OF CONTENT

INTRODUCTION	3
1 current allocation of liability within corporate context	4
1.1 Applicable rules	4
1.1.1 EU regulations	4
1.1.2 National regulations	5
1.2 Identification of relevant modalities of application	6
1.2.1 Trends arising from Ethical charters	6
1.2.2 Relevant case law in EU member states	7
1.2.2.1 The complexity of the structure of the enterprise.....	7
1.2.2.2 "The forum shopping" issue.....	8
2 proposal of reforms.....	10
2.1 Preliminary conditions	10
2.2 Proposal of obligations and related liability scheme	11
2.2.1 Parent company liability	11
2.2.2 Director's liability.....	13
2.2.3 Shareholder liability	15
CONCLUSION	18
APPENDIX 1 - EU regulations	21
APPENDIX 2 - National Regulations –	24

INTRODUCTION

In the current climate of questioning the notion of Corporate Social Responsibility (CSR) and the achievement of sustainable development, the notion of 'corporation' is central. Corporate entities constitute the legal tool used by enterprises to run their business. In this respect a difference has to be made between the notion of 'corporation' and that of 'enterprise'.¹

The aim of the present study, requested by ECCJ, is to provide a working paper for the conference to be held in London on 17th and 18th September. As the reach is wide and concerns heterogeneous legal regulations,² Sherpa has been asked to focus on the relationship between company law and liability issues. In order to fit the limited time available, the study will concentrate on legal rules providing routes to limit the negative externalities generated by the activity of MNEs.³

We think that investigating potential routes for reform of company law, and more specifically allocation of liabilities within a corporate body, at the EU level is relevant. The EU comprises 27 different Member States, each with its own national laws and court structures. Moreover, there are fundamental differences in the nature of the legal systems between Member States: the common law system is in the minority, with the majority of Member States being founded on

a civil law system.⁴ Not only is the complexity of this EU context representative of the challenge of regulating this issue on a large scale, but also the EU provides a relevant institutional forum potentially impacting upon the global CSR debate.

This paper will present in section 1 the major trends in EU regulations and examples of some Member States' national systems. This section will provide the grounds and criteria used for risk and liability allocation within a corporate body generating negative externalities. Section 2 will present proposal of reforms of liability schemes framing CSR.

This presentation of current and potential changes in allocation of liability in the corporate context will distinguish three different levels: liability of parent company, liability of directors, liability of shareholders.

It should also be noted that whatever the legal terms of reform retained, the implementation phase implies taking into consideration the context of international law.⁵ Effective results cannot be achieved without ensuring proper access to justice for victims⁶ and adopting a commonly accepted set of rules on fundamental notions such as *sphere of influence* and related legal tools such as *complicity* or *receipt* in order to determine to what extent can a company be legally bound for acts perpetrated by another legal entity.⁷

¹ Corporation/Enterprise - Not only a mere bank account (ref. D. Howarth, M.P.), the corporation entity provides a legal personality allowing the enterprise to own goods, rent offices, open a bank account, etc. Company law provides also the rules that govern the organisation within the enterprise (between the CEO, Board of directors, general assembly, and unions). Other sets of regulations organise relations between the enterprise and third parties (tax law, labour law, consumer law, competition law, etc). In fact, such collaboration with the aim to make a profit could initially be undertaken through a mere agreement and it should be emphasised that a corporate body is basically an agreement subject to compulsory rules, among which the legislator has framed rules on liability: tortious, criminal, contractual and financial. Hence, the allocation of risk and liability within a company reflects a set of heterogeneous liabilities. It should also be noted that limited liability in practice is merely relative in the case of the small scale company with a small number of shareholders. And it is remarkable to note, however, that an individual natural person will very likely face unlimited (or at least liability higher than the value of her/his shares through guarantees given to banks) personal liability as a lone shareholder whereas when such shareholders form a corporate body, this latter effectively benefits from limited liability (thanks to the financial support of the parent company, itself governed by limited liability rules).

² Potentially, rules regulating companies' activity come within various areas of law: company, tax, consumer, competition, contract, environmental, intellectual property, and administrative, all potentially referring to specific liability schemes under tortious and criminal rules.

³ Which means that this paper will not deal with the rules on liability enacted to protect the company's interest (such as derivative actions), except when necessary.

⁴ *An overview of collective actions and D & O liabilities in England, France, Germany, Italy, the Netherlands and Spain* - United Kingdom: European Litigation Trends [Freshfields Bruckhaus Deringer - 25 July 2007].

⁵ Indeed, home States on their own have insufficient influence to apprehend bad practices perpetrated by their national companies' subsidiaries abroad. If numerous national legislations have tort rules, less have enacted criminal liability principles for corporate bodies. However, the notions of corporate veil and its corollary, the principle of the personality of the offences combined with legal issues of extraterritoriality make a complex legal surface. This is the result of multinationals' *modus operandi* through sometimes dozens of different legal structures bound by various legal status. This legal context generates great difficulties in practice to enforce existing 'hard' legal tools [see Sherpa's study *The OECD Guidelines for Multinational Enterprises - An evolving legal status* - Yann Queinnec - June 2007 - <http://asso-sherpa.org/reflexions/SHERPA%20OCDE%20Legal%20Study%20V150607.pdf>].

⁶ This question relates to institutional issues of *jurisdiction*. Considering the scope of the paper, this fundamental issue will only be dealt with through supplementary remarks.

⁷ International customary law might be of great help in generating such a set of rules, at least for interpretative purposes [see section 2 of Sherpa's study *The OECD Guidelines for Multinational Enterprises - An evolving legal status* - Yann Queinnec - June 2007].

1 CURRENT ALLOCATION OF LIABILITY WITHIN CORPORATE CONTEXT

This paper uses the European Commission's working definition of CSR, namely: "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". We also consider the consensus stating that CSR is behaviour by businesses over and above their legal requirements and is intrinsically linked to the concept of sustainable development.⁸

This mention of existing legal requirements appears in the paragraph of the Commission's communication dated 2nd July 2002 as a specific comment on the definition of CSR. This statement brings us to the conclusion, and this paper tends to demonstrate it, that CSR is primarily made from existing laws. Its legal framework is made from a wide range of legal tools governing various issues (company law, tax law, consumer law, competition law, contract law, environmental law, intellectual property law, administrative law and related rules of liability arising from tort and criminal law) with different territorial extent of application: from local to national, regional (such as European law) and international laws.

The heterogeneity of this package of rules designing CSR demonstrates not only that European company law is relevant but also that national jurisdictions remain strategic, so as international law sphere.

1.1 Applicable rules

As background to this working paper and our proposals for EU law reform, we briefly summarise existing European law and some features of Member States' rules generating corporate liability.

1.1.1 EU regulations

See the table in Appendix 1

The admission of corporate liability by the EU is not a new phenomenon. The liability of a company for its branch or agency's conduct has

been admitted since 1983 for instance.⁹ Moreover, a parent company, established in European territory, can be liable for damage caused by its subsidiaries located abroad, through its effective control exercised over these.¹⁰

Regarding specific regulations, the EU tries to establish frameworks on environmental and social liability in order to unify Member States' laws.

European Directive 2004/35/CE¹¹ established a no-fault liability scheme for listed activities and a fault or negligence liability scheme for any other activities if these caused damage / a threat to the environment in a Member State. The Directive requires the potential polluter to take preventive and remedial measures in the event of a risk or environmental damage.

Besides this binding provision, the European Commission established a Community eco-management and audit scheme (EMAS), which aims to promote improvements in the environmental performance of European companies¹². The Commission recommended the inclusion of environmental and social considerations to a company's reporting obligation, applicable to individual and consolidated accounts, and therefore, to all consolidated entities¹³. This recommendation suggested also that multinationals analyse situations of human rights violations¹⁴. Very recently, the establishment of a minimum set of

⁹ Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31983L0349:EN:HT ML>

¹⁰ See ECJ 16 November 2000, Case C-286/98 <http://curia.europa.eu/juris/cgi-bin/form.pl?lang=en&Submit=Rechercher&alldocs=alldocs&docj=docj&ocop=docop&docor=docor&docjo=docjo&numaff=C-286/98&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100>

¹¹ Directive 2004/35/CE of the European Parliament and the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage, http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_143/l_14320040430en00560075.pdf

¹² Regulation (EC) No 761/2001 of the European Parliament and of the Council of 19 March 2001 allowing voluntary participation by organisations in a Community eco-management and audit scheme (EMAS), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001R0761:EN:HT ML>

¹³ Recommendation by the EC on 30 May 2001, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_156/l_15620010613en00330042.pdf, Directive 2006/46/EC of the European Parliament and the Council of 14 June 2006, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf.

¹⁴ Howitt Report on the Annual Report on Human Rights in the World 2005 and the EU's policy on the matter adopted by the European Parliament 18 July 2006, <http://www.europarl.europa.eu/sides/getDoc.do?language=FR&pubRef=-/EP//NONSGML+REPORT+A6-2006-0158+0+DOC+PDF+V0//EN>

⁸ Communication from the Commission dated 2nd July 2002 - COM (2000) 347, p.5 - http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc_127374.pdf

criminal offences for environmental damage was proposed.¹⁵

These mechanisms reinforce the possibility for companies' to be accountable for the impact of their activities, especially on the environment but remain limited in other aspects.

First, although the reporting obligation applies to all consolidated entities, the scope of environmental liability is limited to damage caused in EU territory and the scope of criminal offences is not determined. This makes difficult the recognizance (recognising that a particular rule or regulation binds the subject) of a multinational's environmental accountability beyond the European territory. Second, these regulations are not binding in matter of social issues neither are they for human rights violations, which reduces their scope of application.

One of the most useful EU legal tools today are the regulations on jurisdiction and applicable law¹⁶ established by the Brussels I Convention¹⁷ and the Rome II Regulation¹⁸. These provide that a parent company, liable for damage caused by its subsidiary abroad, may be sued in a European jurisdiction which can apply, in some cases, its own national law.

1.1.2 National regulations

See the table in Appendix 2

The existing rules regarding human rights and environment protection in most European countries concern physical persons. For instance, States have their own duties to protect human beings from human rights violations. MNCs have a hybrid legal status with strong social obligations (consumer law, labor law namely). This results from the fact that MNCs wield more power and influence on their environment than individuals do. The current

efforts of the European Commission¹⁹ to unify European regulations regarding enterprises could help by giving legal duties to MNCs to respect human rights, environmental legislation or social legislation, because until now, claimants have had to use inappropriate legal tools when suing MNCs.²⁰

In analysing Member States' laws, it is interesting to underline that corporate criminal liability is not always enacted. On the one hand, that demonstrates the difficulties to apprehend the legal frame of this specific subject of law. The question of corporate criminal liability remains debated as if it constitutes an efficient policy tool. Image constraint might generate more deterrent effect. However, in the current context, and namely the growing influence of MNCs, criminal liability represents at least an initial step toward concrete CSR. As a result, this lack of criminal liability is a stumbling block to CSR, only directors being potentially sued for criminal charges.

Nevertheless, more and more States understand the necessity of broadening access to justice in favour of the victims of companies' activities. Indeed, whereas class actions²¹ have not commonly been enacted throughout EU, European laws state that some associations have the power to bring collective actions against companies.

Furthermore, directors' liability can be sued, subject to several conditions, by shareholders (by way of derivative actions) investors and third parties, for damage caused by fault or intentional misconduct.

Despite the new European trend to establish corporate environmental and social liability, it is too early to analyse its impact on Member States' laws. Although this matter is becoming ever more significant, at present few binding provisions on the subject exist. Moreover, it appears that these existing rules remain

¹⁵ Proposal for a Directive of the European Parliament and of the Council on the protection of the environment through criminal law, http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0051en01.pdf

¹⁶ This issue will be developed in 1.2.2

¹⁷ Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_012/l_01220010116en0001_0023.pdf

¹⁸ A proposal to replace the Rome Convention 19 June 1980 on the applicable law regarding **contractual obligations** with a "Rome I" regulation was launched by the European Commission in 2005, reference COM (2005) 0650 final. On applicable law regarding **non-contractual obligations**, the "Rome II" Regulation was finally adopted in May 2007 by both the European Parliament and the European Council. http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/l_199/l_19920070731en0040_0049.pdf

¹⁹ Communication from the Commission and the Council and the European Parliament, "Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward", Brussels, 21.5.2003, COM (2003) 284 final. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52003DC0284:FR:NOT>

²⁰ In August 2002, two claimants lodged a claim before the French criminal court against the company, TotalFinaElf. They were victims of forced labour in Myanmar where an affiliate of TotalFinaElf was operating. The French court had jurisdiction but the problem which arose was that the **offence of forced labour did not qualify as a criminal charge under French law**.

²¹ A class action allows a large group of people (e.g. consumers) who suffered a common loss to bring a collective action.

uncompleted or unsuitable and do not reach the initial target.

In this regard, in France a draft bill in 2007²² transposed the European Directive on Environmental Liability but its geographical scope was not clearly identified. The Directive's translation in Italy was considered a failure, establishing a less protective scheme than before.

As concerns the provisions on the reporting obligation, both the French bill²³ and English draft bill (CORE Bill²⁴) constitute improvements on the matter, even though it remains fundamental to establish a European standard defining common indicators.

1.2 Identification of relevant modalities of application

The concept of CSR covers both a **voluntary** application of principles by the MNCs themselves and a **restrictive** application of laws and rules by courts.

Voluntary - On the one hand, studying ethical charters (also known as codes of conducts) reveals the broader issues these cover compared to the existing binding national, regional and international rules. From this perspective, their development should still be encouraged even though a damage victim cannot today sue a company for violation of its code of conduct.

Restrictive - On the other hand, the analysis of case law discloses the many obstacles claimants encounter when suing a MNC which therefore prevent them from recovering compensation following the establishment of a MNC's liability. Indeed, the aim of seeking to set up rules applicable to MNCs is to be able to ask before a judge for these to be respected. Denying²⁵ this fundamental right results in violation of

fundamental principles such as equality before the law and generates deny of justice.

1.2.1 Trends arising from Ethical charters

The voluntary self regulation of MNCs through ethical charters has revealed the important role MNCs play in respect of certain environmental or social areas. Through those ethical charters, MNCs choose to commit themselves to various principles²⁶ that will govern their activities. These reveal the general policy of the corporation and are commonly applicable to its agencies, branches and subsidiaries.

Various types of ethical charters exist: some are internal to the corporation and prepared by the corporation itself; others involve third parties such as NGOs; only a few are written by external actors (NGOs, IO, Unions, etc) without the participation of the corporation itself, and are then submitted to MNCs for their approval. Ethical charters can be found in specific fields such as the extractive sector, the textile and chemical industry. MNCs that choose to elaborate a charter are those exposed directly to public opinion. They select the principles to which they want to adhere; in this regard, they are well positioned to know which principles they need according to their activity areas. But on the other hand, they decide themselves what they want to adhere to and which topics they want to include or not. This strategy can help them to commit themselves in fields which will cost nothing and often do not refer expressly to the existing international convention but limits their commitment in an area to very general terms which helps them to impose their own interpretation of the situation.

Despite the various criticisms that arise when analysing ethical charters, due to their public relations motivations, they could be used as a great legal tool. Most of the rules contained in **international conventions** target States or human beings and it is still debated if they are directed to MNCs. National regulations on the prohibition of torture, forced labour, non-discrimination, etc do exist but **those**

²² Draft Bill on Environmental Liability, 5 April 2007, <http://www.senat.fr/leg/pj106-288.html>

²³ Article 116 of the NRE bill, 15 May 2001: <http://www.legifrance.gouv.fr/WAspad/UnTexteDeJorf?numjo=ECO0000021L>

²⁴ CORE Draft Bill, 19 June 2003, http://www.publications.parliament.uk/pa/cm200203/cmbills/129/2003_129.pdf

²⁵ Denying the right to access to justice would consist of not taking into account the specificity of suing a MNC. Special rules have been formulated to enable the filing of complaints against a Nation State before national courts as existing rules for suing individuals could not be used. The same specificity and difficulty should be taken into account regarding MNCs.

²⁶ These internal guidelines usually refer to international principles, standards or rules. According to a study of 140 ethical charters done by CMT, the main principles MNCs choose to adhere to are health and safety at work and non-discrimination (respectively, 74% and 69% of the charters studied refer to those two principles). Surprisingly, only 32% of the charters studied refer to forced labour and 35% to child labour; only 24% of MNC charters refer to the freedom of association, when this is an international standard guaranteed by an ILO convention. CMT, "La responsabilité sociale des entreprises et les codes de conduite", April 2004, www.cmt-wcl.org.

obligations remain national and therefore not adapted to the transnational activities of MNCs. Moreover, due to the principle of sovereignty, State cannot regulate the activities of their corporations abroad. However, as ethical charters are non-binding documents, MNCs insert broader principles than exist in legislation. Therefore, by expressing their commitment to certain principles, MNCs make declarations. Those declarations are ruled by laws and any false statement can potentially engage the liability of the directors²⁷. Through those rules, any State recovers its regulatory role as it has not been involved in the process of setting up those charters.

As a matter of fact, the question of control of the implementation of an ethical charter is crucial as without any external control, MNCs can declare anything they want: nobody will know if this is being effectively implemented. Indeed, MNCs which have adopted ethical charters commonly do not provide a follow-up process. As a result, by ruling on the obligation to make reports, the State recovers its natural role of regulation and can recover control to certain extent on these specific subjects of law. The burden of this obligation should be upon the main entity located in the regulating State as being the entity which controls the others. The EU should rule on the obligation MNCs have to honour their commitment and therefore organise a special liability based on this matter as we will develop in the second part of this study.

1.2.2 Relevant case law in EU member states

More and more victims of MNCs' activities are claiming compensation before judges for the violation of human rights or environmental rules and are seeking in this way to establish MNCs' liability.

Most of the judicial cases arising in the last 15 years took place in the United States, under the Alien Tort Act, and in Europe. The development of judicial cases in developing countries has also to be noted.

Despite this trend, demonstrating that MNCs can be asked to answer before the courts for violations of international, regional or national rules causing damage to physical persons,

obstacles to the access to justice remain too high.

From the analysis of case law two main barriers are revealed:

- The complexity of the structure of the enterprise. Who is to be sued: the subsidiary which was in direct connection with the victim or the parent company which is based in Europe?
- The theory of *forum non conveniens*, existing in the common law system. This deals with the question: which court of which country is the most appropriate to deal with the case?

1.2.2.1 The complexity of the structure of the enterprise

Also known under the term "corporate veil", the principle of separation of legal entity between different companies is universally regarded as fundamental. "Using complex and confusing corporate structures, MNCs have been unable to distance and separate the parent, headquarters, and company from the local operating subsidiaries, thereby protecting the MNCs from legal liability".²⁸ One of the most famous cases in England regarding a company's liability, *Lubbe v. Cape plc* in 1997, illustrates this issue. In this case, the main issue raised by the plaintiffs' claim was put in this way: "*whether a parent company which is proved to exercise de facto control over the operations of a (foreign) subsidiary and which knows, through its directors, that those operations involve risks to the health of workers employed by the subsidiary and/or persons in the vicinity of its factory or other business premises, owes a duty of care to those workers and/or other persons in relation to the control which it exercises over and the advice which it gives to the subsidiary company?*" In this case, five employees of an asbestos mining company located in South Africa and managed by a subsidiary wholly owned by Cape plc, a company domiciled in England, lodged claims for compensation. They suffered from an asbestos-related cancer. They sued Cape plc, the parent company incorporated in England for its liability, based on its negligent control of its subsidiaries' operations which it should have made limit the workers' exposure to asbestos at a safe level. The English court

²⁷ Appendix 2

²⁸ « Liability of Multinational Corporations: a critical stage », R. Meeran, 1999.

accepted jurisdiction. The court indicated that the duty owed by an English company should be determined by English law. It paid attention to the fact that “the alleged breaches of duty of care took place in England rather than South Africa.” This decision is in accordance with the position of the European Court of Justice which considers that a parent company can be liable for subsidiaries’ conduct.²⁹

The central issue in cases involving a MNC is **whether or not the parent company owes legal duties to those affected by its subsidiaries’ or affiliates’ operations.** If the effective control of a parent company over its branches can be easily demonstrated, proving the same regarding a subsidiary is more difficult. Indeed, MNCs can easily avoid being accused by arguing that the entity which caused the damage is independent; the legal principle of “separation of corporate identity” enables MNCs to avoid liability and allows parent companies not to be responsible for the entities they control except where the claimant succeeds in proving that the independence is fictitious. The ECJ in its 16 November 2000 decision, gave tools in this regard, but case law does not replace compulsory regulations.

For this reason, one solution Sherpa is proposing is to place on the parent company the burden of a fundamental obligation to prevent and correct and to elaborate at the European level, a new scheme of responsibility for MNCs based upon this. As a result of this, complex company structures would become useless and claimants would be able to sue the parent company incorporated in a European country.

1.2.2.2 “The forum shopping”³⁰ issue

Most cases involving MNCs raise the international private law issue of jurisdiction (also named: the forum).³¹ This is the main

characteristic of cases where the parent company is incorporated in a European country and its branches or subsidiaries operate in other countries. Most, those entities generate damage in the country where they carry out their activities but the victims try to sue the parent company when it appears that it controls the decisions of its foreign entities.

The question is therefore which is the proper jurisdiction to deal with the case: the court of the country where the parent company is incorporated or the court of the foreign entity where the damage occurred. Generally, claimants consider that European courts offer more appropriate protection and guarantees than justice in their home states. For this reason, more and more claimants try to bring the proceedings in the state where the parent company is incorporated. The problem is that English law still applies the doctrine of *forum non conveniens*.

This doctrine allows the defendant to demonstrate that there is another “clearly and distinctly more appropriate forum” elsewhere and that justice as between the parties will be done in that forum. Judges have therefore to determine which jurisdiction has the most real and substantial connection (*conveniens* factors)³² with the case. Most MNCS try, therefore, to apply to stay the proceedings on the ground of *forum non conveniens*. The effect of this doctrine has been to enable MNCs to avoid legal responsibility as the crux of the matter (that is to say whether or not the company is liable) is not argued and the discussion remains on procedural issues. The problem is the lack of rules enforceable to the parent companies for the activities of the entities they control. Indeed, most of the times the *conveniens* factors will always be point to the State where the agency, the branch or the subsidiary has its activities. Even though EU Regulation 44/2001 on Jurisdiction proposes a

²⁹ ECJ 16 November 2000, Case C-286/98: Where the subsidiary has a separate legal personality, the parent company is liable if it exercises an effective control over its subsidiary and restricts its autonomy. To demonstrate this control, the decision refers, for instance, to the situation where the parent company holds 100% of shares stating that it constitutes a first presumption that should be completed by other elements such as presence of representatives on the subsidiary’s board of directors. This does not exclude a parent company’s liability where it holds less than 100% of the share capital provided that the criteria of the exercise of an effective control are met. However, even though this ECJ decision can help to apprehend the difficulties coming from the complexity of the structure, the terms “effective control” over the subsidiary remain hard to determine.

³⁰ This is the informal name used by litigants; it refers to the choice of the forum plaintiffs have in international litigations.

³¹ Thor Chemicals Holding Ltd/ Desmond Cowley case: Thor manufactured mercury-based chemicals in South Africa. In February 1992, several cases of poisoned workers were reported. 20 workers sued the parent company, based in England and its chairman Desmond Cowley, before the English High Court. The claimants alleged that the

company had been negligent in its operation, supervision and monitoring as it had failed to protect the South African workers against the foreseeable risk of mercury poisoning. Thor raised the *forum non conveniens* defence, but the judge rejected its application and recognized the connection between the claim and England. In the RTZ case the main legal issue was again the *forum* one. A claim was brought by Mr. Connelly, a cancer victim employed at RTZ’s Rossing uranium mine in Namibia, before the English Court. The defendant, RTZ, argued that England was not the appropriate forum. The claimant had therefore to prove why justice could not be done in the Namibian forum. The English judge stated that the appropriate forum was England as the claimant would not have been able to have access to the Namibian court because of lack of financial assistance there. Even though those two cases ruled in favour of the claimants, the existence of this doctrine does not provide sufficient predictability of outcome as the decision regarding jurisdiction is a matter of the judge’s discretion.

³² The *conveniens* factors taken into account could be the location of witnesses or documents, the location of victims, etc.

solution that should avoid the application of the *forum non conveniens* doctrine³³, a more efficient solution would be to create rules that aim at parent companies incorporated in the EU directly, and that are enforceable. By doing so, the harmful event would be considered to be in the EU State where the parent company is located even though the damage occurred abroad. This would ensure that EU national judges accept their jurisdiction in compliance with the Brussels I regulation.

LESSONS

This brief outline of EU and Member States' regulations shows that various legal tools already frame corporate liability at the EU level and take into consideration the whole range of CSR concerns³⁴ either directly or indirectly.

We believe, accordingly, that the first priority is to respect existing obligatory regulations. This implies reducing the inappropriateness of some fundamental company law features (corporate veil, limited liability and their major practical results: complex corporate structure influencing causation) that generate major obstacles on the way to fair and equitable corporate liability.³⁵

³³ The EU Regulation 44/2001 regarding jurisdiction and coming from the Brussels Convention 1968 is supposed to prevent forum shopping. Indeed, it unifies the conflicts rules of jurisdiction by stating when EU courts should have jurisdiction. Nevertheless, English courts still apply the doctrine of *forum non conveniens* even when the rules of the EU regulation give them jurisdiction. According to this regulation, a parent company established in any EU territory is liable for damage caused by its subsidiaries abroad, through its effective control exercised over these and may be sued before an EU court in two situations. The competent court can be:

- the court where the defendant is established, so the court where the parent company is domiciled
- the court where the harmful event has occurred: if a decision taken by the board of directors of the parent company has caused the damage, the court where the parent company is domiciled is competent.

As regards applicable law, the court may apply the law of the country where the parent company is domiciled (so the law of the forum) if it considers that the decision taken by its directors constitutes the harmful event (See Rome II regulation (EC) 864/2007, 11 July 2007) . See Appendix 1.

³⁴ Which are concerns for general interest issues combined with the influence a subject of law (a company) which may have (either positively or negatively) on third parties.

³⁵ Others causes of concern arise such as the procedural issue of extraterritoriality. "Already in the present state of EU law, specifically, under the 'Brussels I Regulation n°44/2001 of 22 December 2000, the national courts of the EU Members States must accept jurisdiction over civil liability claims filed against any defendant, including corporations, domiciled on their territory, wherever the damage took place and whatever the nationality of the claimants" [see Olivier De Shutter's discussion paper *Towards Corporate Accountability for Human and Environmental Rights Abuses*]. Another major issue is the absence of detailed mandatory reporting obligations and the need for common rules of interpretation for key notions such as 'sphere of influence'. Indeed, taking into consideration corporate liability, particularly for

However, to ensure the success of any type of proposal for reform a strong conceptual framework has to be agreed. We suggest using a frame of analysis which we believe fits the current accepted definition of CSR. **This arises from the previous paragraphs that CSR can be presented from a dual perspective, one compulsory and the other voluntary.** In this respect, the *voluntary face* of CSR should only concern supplementary ('over and above legal requirements'³⁶) initiatives from companies which as such would qualify as philanthropy.

Regarding the compulsory *face* of CSR, we propose basing a new scheme of responsibility on two fundamental grounds: the precautionary principle and the various civil liability schemes. This responsibility would allow victims to recover directly for individual injury and property damage.

First, the **precautionary principle** is mentioned in EU legislation regarding environmental liability. Specifically, Article 174 of the EU Treaty states that "*Community policy on the environment (...) shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay*". According to this legislation, the precautionary principle: "*should be considered within a structured approach to the analysis of risk which comprises three elements: risk assessment, risk management, risk communication*".³⁷ The measures resulting from the use of this precautionary principle should take the form of a decision from the parent company to act or not to act. In order to enforce this principle the reporting obligation should be adapted to the scope of MNCs and implemented in legislation as a binding provision.

multinationals, confronts victims and judges with extremely challenging legal difficulties linked to extraterritoriality and complex corporate structures which characterizes MNCs *modus operandi*. Setting common views on the degree of influence necessary to regulate a parent company for subsidiaries externalities has become a key issue. This should arise from a benchmarking of the best practices developed by jurisdictions, arbitration courts or any other institutions settling disputes and 'stating the law' (WTO, OECD National Contact Points and ILO for instance) in order to generate a *parent-based extraterritorial regulation* as suggested by numerous authors. Due to the limited scope of this paper, we cannot study these issues in details.

³⁶ Communication from the Commission dated 2nd July 2002 [COM (2000) 347, p.5 -

http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc_127374.pdf

³⁷ Communication from the Commission of 2 February 2000 on the precautionary principle, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52000DC0001:EN:HTML>

Responsibility schemes vary depending on the country. At the EU level, only professional liability schemes exist. They mainly concern responsibility of professionals towards States or individuals.

In this respect, the Directive 2004/35/EC of the European Parliament on Environmental liability³⁸ establishes a no-fault liability scheme for listed activities and a fault, or a negligence liability scheme for any other activities if they have caused damage / a threat to the environment in a Member State. The Directive requires the potential polluter to prevent environmental damage or imminent threat of damage resulting from its activities and to bear the cost of preventive and remedial measures. This special responsibility cannot directly ground legal action brought by individuals.

The proposal for a regulation of the European Parliament and the Council on the liability of carriers of passengers by sea and inland waterways in the event of accidents, COM (2005) 592 2005/0241/COD, puts forward responsibility schemes based on no-fault, fault, and negligence. The main difference between these three responsibility schemes relies on the level of control the professionals have on the activity which causes the damage.

We suggest in this report to keep this EU approach regarding professional liability for corporations.

Besides this civil responsibility scheme, the ECJ³⁹ and the recent proposed directive in 2007⁴⁰ emphasize the necessity to implement **criminal liability** for combating serious environmental offences. For this reason, we propose that a violation of the precautionary obligation should generate a criminal liability.

The following proposals use these existing EU legal grounds and extend their effect to matters of human rights violations. In doing so, they tend to adapt them to peculiarities of three key decisional steps

in a MNC (parent company, directors and shareholders).

2 PROPOSAL OF REFORMS

After a brief description of the preliminary conditions, we will present specific proposals for reform based on three potential sources of liability: the parent company, the directors and shareholders.

2.1 Preliminary conditions

As mentioned earlier, the main legal difficulty arises from the concept of *corporate veil* linked with practical issues of extraterritorial complex corporate structures. Indeed, the legal concept of corporate veil⁴¹ is not a relevant concept for assessing the position of enterprises, particularly the largest ones, in the international community. The concept lacks coherence when it prevents liability from being identified and cured.

Solving this problem is not only a matter of **company law** - the great challenge of defining legal borders of a *group of companies*⁴² - but also an issue of **judicial procedure**. The EU could adopt a principle of *parent-based extraterritorial regulation* as many authors have suggested.

Reforming **rules of liability**, considered as *secondary norms*,⁴³ faces also a tremendous legal challenge in the concept of *sphere of influence*. This issue relates to the question to what extent can a company be legally bound for acts perpetrated by another legal entity?

³⁸ Directive 2004/35/CE of the European Parliament and the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage, http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_143/l_14320040430en00560075.pdf

³⁹ Judgment of the Court dated 13 September 2005, <http://curia.europa.eu/juris/p/cj-bin/form.pl?lang=en&newform=newform&Submit=Submit&jurcdj=jurcdj&docj=docj&typeord=ALLTYP&numaff=C-176%2F03&ddatefs=13&mdatefs=09&ydatefs=2005&mdatefe=&ydatefe=&nomusuel=&domaine=&mots=&resmax=100>

⁴⁰ Proposal for a Directive of the European Parliament and of the Council on the protection of the environment through criminal law, http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0051en01.pdf

⁴¹ The concept of corporate veil is a knowingly used by company lawyers for organising corporate and personal impunity.

⁴² The notion of *group* is already recognised by EU law in competition law, labour law and accountancy regulations.

⁴³ 'Secondary norms', i.e. norms establishing consequences of the violation of the 'primary norms' developed in section 1.1. This dichotomy results from Herbert Hart who made the distinction between « les 'normes primaires' et les 'normes secondaires', c'est-à-dire entre les normes posant une prescription ou une habilitation, d'une part, et celles qui indiquent comment reconnaître, produite ou appliquer les normes précédentes d'autre part. Comme l'observe alors Norberto Bobbio, « un ordre juridique est un système qui tend à se maintenir en équilibre dynamique, utilisant des règles du second degré soit pour la conservation soit pour la transformation des règles du premier degré » [*Nouvelles réflexions sur les normes primaires et secondaires, la règle de droit*, Bruylant, 1971, p. 104 – in *Dictionnaire de la culture juridique*, Denis Alland et Stéphanie Riols, PUF, 2003, 1342].

These issues obviously exceed the scope of this paper.

2.2 Proposal of obligations and related liability scheme

Setting effective corporate liability rules implies clarifying the scope of such liability and to do so, as a preliminary step, we suggest that the **EU adopt a general obligation**. This could consist of imposing upon parent companies, directors and shareholders the duty:

- to influence positively on general interest issues according to their respective sphere of influence;
- to ground their decisions and related acts through the filter of the notions of *sustainable development* and *the precautionary principle*.

Such a background rule has the advantage of setting mandatory general conduct, on which judges would be able to assess complaints from victims.

The second step would consist of setting **specific obligations** and related liability using as a starting point the **precautionary principle**.

We have chosen to present the proposal for reforms using the following scheme of analysis:

1. presentation of the obligation
2. nature of the liability incurred (no-fault / fault / negligence schemes and related presumptions)
3. scope of the liability incurred (jointly or severally)
4. exemption from liability
5. related torts / criminal charges
6. request for action
7. interest of the proposal

We believe that these criteria might help to embrace the heterogeneous expression of the corporate sphere of influence to create proportionate related liabilities.

2.2.1 Parent company liability

Preliminary remark – It should be recalled that most human rights and environmental violations are perpetrated by subsidiaries and that parent companies use the corporate veil as

an impunity tool. As a consequence, the scope for application of the following proposals, taking into consideration **parent company** liability, extend to the **“group”** as it has been defined by the EU Seventh Company Law Directive of 13 June 1983 in the matter of **consolidated accounts**.⁴⁴ This is a mere proposal and clearly some entities within a company group remain excluded from the scope of consolidated accounts although these excluded bodies might have substantial impacts on human rights and environmental issues. The fundamental issue of defining the structural scope of parent company liability should be subject to further analysis to select a range of heterogeneous criteria (ownership of shares, common directors, executives, influence of stock option incentive programmes, management fees, transfer pricing, etc).

PROPOSAL N° 1 OBLIGATION TO PREVENT AND CORRECT PARENT COMPANY

1. Presentation of the obligation

- **Mandatory reporting obligation on human rights and environmental matters extended to the notion of group** providing relevant information about each relevant legal entity;
- **Imposing on the parent company that it provides at its own cost effective means for respecting this reporting obligation through the creation of an internal CSR team.**

Modalities – the implementation of such an obligation requires:

- **imposing on companies obligation to allocate a proportionate budget and staff dedicated to CSR issues (internal CSR team)** within its sphere of influence;
- **creating a relevant set of criteria to assess the effectiveness of budget and**

⁴⁴ The Seventh Company Law Directive [83/349/EEC](#) of 13 June 1983, coordinates national laws on consolidated (i.e. group) accounts. This Directive defines in Article 1, the circumstances in which consolidated accounts are to be drawn up. Any company (parent company) which legally controls another company (subsidiary company) is under a duty to prepare consolidated accounts. The scope of these consolidated accounts should be adopted regarding the reporting obligation (coming from the Directive 2003/51/CE).

staff (number of employees, turnover, structure of the group, degree of economical dependence of sub-contractors and suppliers,⁴⁵ sector of activity, management fees and transfer pricing practices, etc.);

- **related mandatory constitution of reserve for human rights and environmental risks** identified by the *internal CSR team*
- **extending the proceeding of recovery** to all Member States so as to give victims access to relevant information.

2. Nature of the liability incurred - TORTS

Two different situations might arise.

A. The parent company do not report OR report is partial – in cases of human rights violations or threat of violation and/or environmental damage or threat to the environment - **tortious liability => the mother company should assume the costs of preventive and remedial measures.**

B. The mother company reports violation of human rights and/or environmental damage or threat to the environment. **Tortious liability** of the parent company might differ depending upon the way the mother company reacts:

- a. **no steps have been taken to prevent risk or take remedial measures =>** damage victims could request the mother company to assume the costs of preventive and remedial measures. The damage victim would demonstrate fault from the mother company by the absence of adequate means (namely confronting them to the respect of modalities of implementation, namely for the *CSR Team*).
- b. **steps have been taken to prevent risk =>** damage victims could request remedies but will **have to prove the fault of the company under the regime of fault or negligence liability scheme.**

3. Scope of liability

The parent company will be **jointly and severally liable** with the others responsible for the threat and damage and the judge will

assess its contribution to the costs of preventive and remedial measures.

4. Exemption from liability

Only in the case of *force majeure* and if the damage or the threat was caused by a third party or resulted from compliance with a compulsory order or instruction from a public authority; or if the operator is not at fault or negligent and if the activity is not likely to cause environmental damage according to the state of knowledge.⁴⁶

5. Related tort/criminal charge

The obligation to prevent and correct is a general one. The related legal charges would be of a tortious nature using the liability scheme described above. However, to strengthen this liability scheme we suggest the EU adopt a criminal liability device based upon the notion of *unwilling violations* (see proposal n°2 hereafter).

6. Request for action

Any natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, etc.) can take preventive or remedial measures in cases of urgency and recover the costs incurred from the parent company.

7. Interest of the proposal

The parent company has to disclose the structure of the *group* in order to assess the proportionate needs of the *internal CSR team*. This indirectly provides grounds for the liability of the parent company. Indeed, this obligation discloses the *sphere of influence* of a company group.

⁴⁵ The issue of *supply chain* will be the subject of a second paper by Sherpa which is in preparation.

⁴⁶ Refers to the liability scheme of the Directive 2004/35/EC (see Annexe 1).

PROPOSAL N° 2
LIABILITY FOR UNWILLING VIOLATIONS
PARENT COMPANY

1. Presentation of the obligation

To complement the deterrent effect of proposal n°1 we suggest the EU adopt a **criminal liability** device based on the notion of *unwilling violation* as has been enforced in France since 2001.⁴⁷ This could be worded as follows:

*"A misdemeanour also exists, where the law so provides, in cases of **recklessness, negligence, or failure to observe an obligation of due care or precaution imposed by any statute or regulation or resulting from unilateral engagement expressed through ethical charters**, where it is established that the offender has failed to show normal diligence, taking into consideration where appropriate the nature of her/his role, functions, capacities and powers and of the means then available to her/him".*

2. Nature of the liability incurred - CRIMINAL

The victims would be able to bring a criminal action on this ground, potentially providing support to tort law issues.

3. Scope of liability

The parent company will be **jointly and severally liable** with others responsible for the damage and the judge will assess its contribution to the remedies accordingly.

4. Exemption from liability

Only in the case of *force majeure*.

5. Related tort/criminal charge

Sanctions: the sanction already provided in national penal codes or at the discretion of Member States in the same terms as that in the Directive 2004/35/CE on the environment. Among others these are: fines, prohibition of the right to participate in public tenders, insertion of notices in the media at the company's cost, etc.

⁴⁷ Article 121-3 para. 3 of the French Penal Code.

6. Request for action

Any natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, etc.) can take preventive or remedial measures in cases of urgency and recover the costs incurred from the parent company.

7. Interest of the proposal

This proposal strengthens the possibility to regulate the parent company for the acts of other legal entities constituting the *group*. It should be recalled that proposal n°1 suggested above should be helpful in postulating the control of the parent company on the others within the corporate structures.⁴⁸

2.2.2 Director's liability

Background to the proposals - It should be noted that a recent Directive on corporate governance,⁴⁹ which entered into force on the 5 September 2006, mentions that "*Those bodies (members of the administrative, management and supervisory bodies of a company) act within the competences assigned to them by national law. This should not prevent Member States from going further and providing for direct responsibility towards shareholders or even other stakeholders. On the other hand, Member States were to refrain from opting for a system of responsibility limited to individual board members. However, this should not preclude the ability of courts or other enforcement bodies in the Member States to impose penalties on an individual board member*". This last reference to penalties is interesting as it does not fit the much more offensive regulation arising from Directive n°2004/35/CE on environment.

⁴⁸ See above Proposal n°1 section *Interest of the proposal*.

⁴⁹ Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 - with 5 September 2008 as a deadline for transposition to member states. In line with the [Action Plan for modernising company law and corporate governance](#) this Directive seeks to facilitate cross-border investment, enhance the comparability of financial statements and annual reports throughout the European Union and increase public confidence in these documents, by including specific information of better quality and with a uniform content. More specifically, it sets out the requirements of transparency as regards "related parties" and "off-balance-sheet operations" and requires all firms, apart from small ones, to produce an annual corporate governance statement in a clearly identifiable section of the annual report. [http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Directive&an_doc=2006&nu_doc=46].

This current EU law context gives grounds and room for a supplementary EU obligation upon directors, creating a binding link between **reporting requirements and human rights and environmental corporate liability**. Indeed, reporting represents a tool for the prevention of the abuse of human rights and environmental harms and as such, these major causes of concern should legitimately integrate a sanction mechanism upon the directors as they have to monitor the reporting obligation which play a preventive role..

With such a liability on directors pressure would put on the companies' executives to provide directors with highly valuable information from the field upon which to ground decisions. **It should be noted that directors' liability, described hereafter, should be extended to all persons having a mandate to represent the company.**⁵⁰

PROPOSAL N° 3 OBLIGATION TO PREVENT AND CORRECT DIRECTORS

1. Presentation of the obligations

Directors will be in charge of implementing the reporting obligation described in proposal n°1 and as such should bear the following obligations.

- **Mandatory reporting obligation on human rights and environmental matters extended to the notion of group** providing in the annual report detailed information on each relevant legal entity;
- **Impose that directors ensure that the parent company has provided at its own cost, the effective means for respecting this reporting obligation by the creation of an *internal CSR team*.**
- **Imposing upon directors the duty to take all preventive measures where the risk of damage has been reported**

2. Nature of the liability incurred - TORTIOUS

Directors bear the same **tortious liability** as the parent company (see proposal n°1 section 2)

3. Scope of liability

The Directors will be **jointly and severally liable** with others responsible for damage and the judge will assess the directors' contribution to the remedies accordingly (**subsidiary / parent company / shareholders**).

4. Exemption from liability

Only in the case of *force majeure* and if the damage or the threat was caused by a third party or resulted from compliance with a compulsory order or instruction from a public authority; or if the operator is not at fault or negligent and if the activity is not likely to cause environmental damage according to the state of knowledge.

5. Related tort/criminal charge

This obligation to prevent and correct is general. The related legal charges would be of a tortious nature using the liability scheme described above. However, to strengthen the liability scheme we suggest that the EU adopt a criminal liability device based on the notion of *unwilling violations* (see proposal n°4 hereafter).

6. Request for action

Any natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, etc) can take preventive or remedial measures in cases of urgency and can recover the costs incurred from the operator responsible.

7. Interest of the proposal

This liability of directors mirroring that of the parent company implies that the board will have to put pressure on the companies' executives to provide them with highly valuable information from the field upon which to base effective decisions (through the work performed by the *internal CSR team*).

⁵⁰ French law extends the scope of application of criminal liability to directors, officers and executives.

PROPOSAL N° 4 LIABILITY FOR UNWILLING VIOLATIONS DIRECTORS

1. Presentation of the obligation

To complement the deterrent effect of proposal n°3 we suggest that the EU adopt a **criminal liability** device based on the notion of *unwilling violations* as has been enforced in France since 2001.⁵¹ This could be worded as it follows:

*"In the case as referred to in the above paragraph, **natural persons** who have **not directly contributed to causing the damage, but who have created or contributed towards creating the situation which allowed the damage to happen and who failed to take steps enabling this to be avoided**, are criminally liable where it is shown that they have breached a duty of care or precaution laid down by statute or regulation **or resulting from unilateral engagement expressed through ethical charters** in a manifestly deliberate manner, or have committed a **specified misconduct** which exposed another person to a particularly serious risk of which they must have been aware."*

2. Nature of the liability incurred - CRIMINAL

The victims would be able to bring a criminal action on this ground, providing support to tortious law issues.

3. Scope of liability

The Directors will be **jointly and severally liable** with others responsible for damage and the judge will assess The directors' contribution to the remedies accordingly (**subsidiary / parent company**).

4. Exemption from liability

Only in the case of *force majeure*.

5. Related tort/criminal charge

Sanctions: the sanction already provided for in national penal codes or at the discretion of Member States in the same terms as that in the Directive 2004/35/CE on the environment.

Among others these are: fines, disqualification of directorship for a limited period of time, etc.

Specific sanctions:

- Individual fines
- Freeze or expropriation of stock-options
- Disqualification from holding any directorship for a limited period (such as exists in bankruptcy matters)

6. Request for action

Any natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, etc) can take preventive or remedial measures in cases of urgency and recover the costs incurred from the operator responsible.

7. Interest of the proposal

This criminal liability of directors, mirroring that of the parent company, should generate an interesting deterrent effect motivating directors to implement efficiently their reporting obligations.

2.2.3 Shareholder liability

The notion of liability challenges the DNA of a share and imposes reversion to its fundamental characteristics. Various types of shares have been created in order to modify the control of companies in such a way that stating that shareholders own and control a company is no longer true. It should also be noted that creation of most of the new types of shares results from the practice and have in a second step been subject to regulation.

As mentioned in the introduction, company law has organised the defence of companies' interests where confronted with abuses by their directors. 'Derivative' actions have been enacted in various EU States to protect in-house stakeholders (shareholders). An interesting counterpoint is that shareholders cannot, even by a unanimous decision, cover up for the liability of a director by voting favourably for a resolution generating, for instance, a misuse of

⁵¹ Article 121-3 para. 3 of the French Penal Code.

a corporate asset which is legally enacted in the criminal code.⁵²

This situation highlights the difference between the company's and the shareholder's interest. The former is protected from the latter's abuse. More interestingly, in our view, this provides a ground *a fortiori* to recognise the liability of shareholders when their vote generates or allows the company to pursue investment damaging a third party's interest (general interest).

Another point which could legitimately increase shareholders' liability arises from the doctrine of 'successor liability'. This contractual practice implies to the extent that the successor company's assets are insufficient to cover the liabilities it agreed to assume, the former shareholders of the selling company remain personally liable.⁵³ Such practice demonstrates that former shareholders consent by contract to assume liabilities they would not otherwise bear in their role as shareholder. This also indirectly means that the former shareholders accepts contractually the potential risk of legal actions from third parties. This gives space to design other risk allocation scheme for shareholders.

Our proposals for reform of shareholder liability take into consideration the current dominating principle of limited liability.⁵⁴ This means that even if we are in favour of a fundamental shift,⁵⁵ we think that intermediary steps could be more likely supported at the EU level. The following proposals also take into consideration the difference in influence between individual and institutional shareholders. These also constitute a logical consequence from the previous proposals of extending company and director's liability on reporting obligations.

Shareholders being the natural beneficiaries of a wider and stricter mode of reporting, they should bear the consequences arising from the exercise of their voting rights if these generate or do not prevent risks and damage.

⁵² *Les Fondements du droit moderne des sociétés* Jean Paillusseau, n° 69 [JCP Entreprises, 1984, n° 13, n° 14193].

⁵³ *Toward Unlimited Shareholders Liability for Corporate Torts* – Henry Hansmann and Reinier Kraakman [HeinOnline – 100 Yale L.J. 1990-1991, p.1885].

⁵⁴ See for instance a recent article stating the dogma of limited liability - *Le principe de responsabilité limitée* Laurent Jobert [Bulletin Joly Sociétés, Février 2007, pp. 225].

⁵⁵ See the various issues raised during the recent Conference organised by SOAS in London on 21 July 2007 and namely the article of Henry Hansmann and Reinier Kraakman *Toward Unlimited Shareholder Liability for Corporate Torts* [The Yale Law Journal 1990-1991, Vol. 1000, pp 1879].

PROPOSAL N° 5 OBLIGATION TO PREVENT AND CORRECT SHAREHOLDERS

1. Presentation of the obligations

Shareholders, in the exercise of their voting rights namely through the refusal to approve annual accounts have to:

- **require the suspension of projects** when reporting obligations are insufficiently informative to assess potential risk in matters of human rights and environmental issues;
- **reject projects** when the reporting obligations demonstrate a substantial risk of human rights or environmental violation;
- **require all the preventive measures** to be taken where the risk of damage has been reported **and remedial measures** when the damage has occurred.

2. Nature of the liability incurred - Tort

Two different situations might arise:

A. The parent company do not report OR report is partial – in cases of human rights violations or threat of violation and/or environmental damage or threat to the environment, **tortious liability** of the parent company is the following => **the shareholders should assume the costs of preventive and remedial measures.**

B. The mother company reports violation of human rights and/or environmental damage or threat to the environment. **Tortious liability** of the shareholders might differ depending upon the way the mother company reacts:

- c. **no steps have been taken to prevent risk or take remedial measures** => damage victims could request the shareholders to assume the costs of preventive and remedial measures.
- d. **steps have been taken to prevent risk** => damage victims could request remedies but will **have to prove the fault of the shareholders under the regime of fault or negligence liability scheme.**

3. Scope of liability

The Shareholders will be **jointly and severally liable** with others responsible for the damage and the judge will assess their contribution to the remedies accordingly (**parent company, directors, shareholders**).

4. Exemption of liability

A distinction should be made between **institutional investors** and **individual shareholders**.

- **institutional investors** should bear a greater liability and this could be based on the notions of *constructive knowledge*⁵⁶ and *legitimate expectation*.⁵⁷ Namely they should only be exempted where they can show that having exercised their right to express their refusal to approve the annual accounts and reports and having exercised all their influence to prevent the company from carrying on;
- **individual shareholders** should be exempted more easily considering that the exercise of their rights have a lesser influence.

5. Related tort/criminal charge

This obligation of prevention and correction being general, the related legal charges would be of a tortious nature using the liability scheme described above. However, to strengthen the liability scheme we suggest that the EU adopt criminal liability devices based on the notion of *receipt* and *unwilling violations* (see proposal n°6 hereafter).

6. Request for action

Any Natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, freeholders), can take preventive or remedial measures in cases

⁵⁶ According to this principle: "if one, by exercise of reasonable care would have known a fact, s/he is deemed to have had constructive knowledge of such fact".

⁵⁷ "The notion of the investor's 'legitimate expectation' has become standard in analysing 'fair and equitable treatment'. It is considered defensible that an investor is not entitled to have expectations which run contrary to customary international law and a fortiori contrary to fundamental rights". We can so consider that directors who do not respect the obligation cannot have legitimate expectations such as being exempted from liability.

of urgency and recover the costs incurred from the operator responsible.

7. Interest of the proposal

This makes a logical link between the liabilities arising from the reporting obligations of the company to the shareholders and should accordingly motivate each actor to demonstrate its concern in the company's way of doing business and acts accordingly to avoid liability (generalisation of the deterrent effect of liability through the whole internal steps of decision from the mere voting rights to the operating decisions).

PROPOSAL N° 6 LIABILITY FOR UNWILLING VIOLATIONS SHAREHOLDERS

1. Presentation of the obligation

To complement the deterrent effect of proposal n°5 we suggest that the EU adopt a **criminal liability** device based on the notion of *receipt* in order to apprehend profit made by shareholders (through dividends):

- **creating the criminal charge of 'receipt' of goods and profits arising from any process where the law of the host country has been violated** (eg. a violation of administrative law such as exploitation licences) and/or where human rights and environment damage has been perpetrated (inspired by German law on illicit importation of protected timber varieties);⁵⁸

We also suggest complementing the deterrent effect of proposal n°5 with a device based on the notion of *unwilling violation* as has been enforced in France since 2001 making a distinction between institutional and individual shareholders.⁵⁹ This could be worded as follows:

Institutional investors:

*"A misdemeanour also exists, where the law so provides, in cases of **recklessness, negligence, or failure to observe an obligation of due care or precaution imposed by any statute or regulation or***

⁵⁸ William Bourdon, Chair of Sherpa, develops this mechanism in his next book due to be published before the end of 2007.

⁵⁹ Article 121-3 para. 3 of the French Penal Code.

resulting from unilateral engagement expressed through ethical charters, where it is established that the offender has failed to show normal diligence, taking into consideration where appropriate the nature of her/his role, functions, of her/his capacities and powers and of the means then available to her/him”.

Individual shareholders:

*“In the case referred to in the above paragraph, **natural persons** who have **not directly contributed to causing the damage, but who have created or contributed to creating the situation which allowed the damage to happen and who failed to take steps enabling this to be avoided**, are criminally liable where it is shown that they have breached a duty of care or precaution laid down by statute or regulation **or resulting from unilateral engagement expressed through ethical charters** in a manifestly deliberate manner, or have committed a **specified misconduct** which exposed another person to a particularly serious risk of which they must have been aware.”*

2. Nature of the liability incurred - CRIMINAL

The victims would be able to bring a criminal action on this ground providing support to tortious law issues.

3. Scope of liability

The shareholders of the Parent company will be **jointly and severally liable** with others responsible for the damage and the judge will assess their contribution to the remedies accordingly.

4. Exemption from liability

Only in the case of *force majeure*.

5. Related tort/criminal charge

Sanctions: the sanction already provided in national penal codes or at the discretion of Member States in the same terms as that in the Directive 2004/35/CE on the environment.

Specific sanctions

- Freezing of dividends

- Expropriation of voting and dividend rights for a determined period of time through a publicly owned fund

6. Request for action

Any natural or legal person who may be adversely affected, i.e. Stakeholders (public administration, environmental protection organisations, trade unions, freeholders), can take preventive or remedial measures in cases of urgency and can recover the cost incurred from the operator responsible.

7. Interest of the proposal

This proposal strengthens the possibility to bind the shareholders for the acts of other legal entities constituting the *group* providing an efficient deterrent effect to encourage shareholders to closely control the action of the company through its reporting obligations and exercise of its voting rights.

CONCLUSION

Another issue which should accompany such reforms relates to proceedings. In Richard Howitt's report adopted by the European Parliament, he proposes to create an observatory with the power to control. We think this would be an interesting tool, partially filling the gap of supra-territorial jurisdictions. It could also be interesting to link such an observatory with the OECD's National Contact Points so as to generate a substantial and constructive case law sharing common interpretative criteria on key notions such as 'sphere of influence' and related issues of 'complicity', 'imputability' and 'causation'.

This working paper is to be used during the Seminar to be held in London on September 18, 2007 and organised by ECCJ.

At this event, a consultation will gather comments from all interested persons.

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APPENDIX 1 - EU REGULATIONS

Liability for infringement: general rules		Lessons
Parent company definition	Directive 83/349/EEC, 13 June 1983⁶⁰ : A parent undertaking ⁶¹ is an undertaking which exercises a management power (majority of voting, appointing or removing rights) a dominant influence over another undertaking (subsidiary undertaking)	<p>1. A parent company, established in the EU territory, can be liable for a damage caused by its subsidiaries abroad, through its effective control exercised over these⁶².</p> <p>2. In such a case, the competent court can be either⁶³:</p> <ul style="list-style-type: none"> - the court where the defendant is established, so the court where the parent company is domiciled - the court where the harmful event occurred: if a decision taken by the board of directors of the parent company has caused the damage, the court where the parent company is domiciled is competent. <p>Third, the court may apply the</p>
Imputation to the parent company	ECJ 16 November 2000, Case C-286/98⁶⁵ . A company is always liable for its branch or agency's conduct. Where the subsidiary has a separate legal personality, the parent company is liable if it exercises an effective control on subsidiary and restricts its autonomy. The decision refers for example to the situation where the parent company holds 100% of shares stating that it constitutes a first presumption which should be completed by other elements to seek its accountability. For instance, the parent company may be liable if it also exercises a certain control or has representatives on the subsidiary's board of directors. This does not exclude a parent company's liability where it holds less than 100% of the share capital provided that the criteria of exercise of an effective control is met. However, even though this ECJ decision can help to apprehend the difficulties coming from the complexity of the structure, the terms «effective control" or "a certain control" over the subsidiary remain hard to delimit.	
Regulation on jurisdiction	Brussels I Convention, 22 December 2000⁶⁶ : The jurisdiction is to be exercised by a Member State in which the defendant is domiciled ⁶⁷ . In the case of legal person, domicile is determined by the country where they have their statutory seat, central administration or principal business. But in matters of tort, delict or quasi-delict, the claimant may sue in the courts of the place where the harmful event occurred or may occur ⁶⁸ . If the harmful event is caused as a result of a decision taken by the parent company's directors, the claimant may sue in the courts where the parent company is domiciled.	

⁶⁰ Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on Consolidated Accounts, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31983L0349:EN:HTML>

⁶¹ The term "undertaking" used in 1983 has been substituted by the term "company".

⁶² See ECJ 16 November 2000, Case C-286/98

⁶³ See Brussels I Convention, 22 December 2000

⁶⁴ See Rome II regulation (EC) 864/2007, 11 July 2007

<p>Applicable Law</p>	<p>Rome II regulation (EC) 864/2007, 11 July 2007, effective the 11th January 2009 ⁶⁹: The principle is the <i>lex loci delicti damni</i>⁷⁰. But in cases of environmental damage, the victim can choose the law of the country in which the event giving rise to the damage occurred⁷¹. Nevertheless, where the foreign law tolerates gross violations of human rights, the European courts, may apply the law of the forum, which respects the EU legislation, like ECHR or environmental provisions.</p>	<p>law of the country where the parent company is domiciled (so the law of forum) if it considers that the decision taken by its directors constitutes the harmful event⁶⁴.</p>
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⁶⁵ Judgment of the Court, 16 November 2000, <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&Submit=Rechercher&alldocs=alldocs&docj=docj&docop=docop&docor=docor&docjo=docjo&numaff=C-286/98&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100>

⁶⁶ Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_012/l_01220010116en00010023.pdf
 Oliver de Schutter, The Accountability of Multinationals for Human Rights Violations in European Law, Center for Human Rights and Global Justice Working Paper Number 1, 2004.

⁶⁷ Article 2.1 of the Council Regulation.

⁶⁸ Article 5.3 of the Council Regulation.

⁶⁹ A proposal to replace the Rome convention 19 June 1980 on the applicable law regarding contractual obligations with a "Rome I" regulation has been launched by the European Commission in 2005, under the reference COM (2005) 0650 final. On the applicable law regarding non-contractual obligations, the « Rome II » regulation has been finally adopted in May 2007 by both, the European Parliament and the European Council. http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/l_199/l_19920070731en00400049.pdf

⁷⁰ This Latin expression means that the law of the country where the direct damage occurred will apply regardless of the country (or countries) where the indirect consequences have occurred. This general principal in Article 4-1 is counterbalanced by exceptions which apply to special torts "where the general rules do not allow a reasonable balance to be struck between the interests at stake" (Preamble item 19, Regulation (EC) 864/2007, 11 July 2007, Official Journal of the European Union)

⁷¹ Article 7 of the Convention.

Liability for environmental and social issues		Lessons
<p>Reporting on environmental and social issues</p>	<p>Directive 83/349/EEC, 13 June 1983⁷²: A Member State shall require any national undertaking to provide a consolidated annual report.</p> <p>Regulation (EEC) No 761/2001 of the European Parliament and of the Council of 19 March 2001⁷³: This allows voluntary participation by companies in the industrial sector in a Community eco-management and audit scheme. The objective is to promote improvements in the environmental performance of organisations in all sectors through the introduction and implementation of environmental management systems, objective and periodical assessment of those systems, training and active involvement of the staff of such organisations and provision of information to the public and the other interested parties.</p> <p>Recommendation by the EC on 30 May 2001⁷⁴: This recommendation requires the recognition, measurement and disclosure of environmental issues in a companies' annual accounts and reports. It applies to individual and consolidated accounts, and thus, to all consolidated entities.</p> <p>EC communication, 19 June 2001⁷⁵: All quoted companies with more than 500 workers should provide a triple analysis in annual accounts based on economic, environmental and social issues.</p> <p>Directive 2006/46/EC⁷⁶: Companies may provide in their accounts an analysis of environmental and social aspects.</p>	<p>The scope of these obligations remain limited.</p> <p>1. Although the reporting obligation applies to all consolidated entities, the environmental liability scope is limited to damage caused in the EU territory and the criminal offences scope is not defined This makes it difficult to take the accountability of the multinational beyond the European territory.</p> <p>2. Second, these regulations are weaker concerning social issues and in the matter of Human Rights violations.</p>
<p>Framework for environmental liability</p>	<p>Directive 2004/35/EC⁷⁷: This is a no-fault liability scheme for listed activities and a fault or a negligence liability scheme for any other activities if there have caused damage/ a threat to the environment in a Member State. The operator, who controls or holds decisive economic power over or holds a permit for such activity, should assume and bear the costs of preventive and remedial measures, under a competent authority's control.</p> <p>Victims and environmental protection organisations may ask the competent authority to act when faced with damage. They can't sue directly the actual or potential polluter.</p> <p>Exemptions: If the damage/ threat was caused by a third party or resulted compliance with a compulsory order or instruction from a public authority, or if the operator is not at fault or negligent and if the activity authorised isn't likely to cause environmental damage according to the state of knowledge.</p>	
<p>Liability for Human Rights violations</p>	<p>Howitt Report⁷⁸: This asks the Commission to develop a strategy for promoting the application of all EU human rights guidelines with multinationals and asks transnational corporations to analyse the gaps in protection of human rights in situations where a host state is unwilling or unable to protect human rights from violations involving companies.</p>	

⁷² See above, note 37.

⁷³ Regulation (EC) No 761/2001 of the European Parliament and of the Council of 19 March 2001 allowing voluntary participation by organisations in a Community eco-management and audit scheme (EMAS), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001R0761:EN:HTML>

⁷⁴ http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_156/l_15620010613en00330042.pdf

⁷⁵ Com(2001) 366 final, http://eur-lex.europa.eu/LexUriServ/site/en/com/2001/com2001_0366en01.pdf

⁷⁶ Directive 2006/46/EC of the European Parliament and the Council of 14 June 2006, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf

⁷⁷ Directive 2004/35/CE of the European Parliament and the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage, http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_143/l_14320040430en00560075.pdf

⁷⁸ Annual Report on Human Rights in the World 2005 and the EU's policy on the matter adopted by the European Parliament 18 July 2006, <http://www.europarl.europa.eu/sides/getDoc.do?language=FR&pubRef=-//EP//NONSGML+REPORT+A6-2006-0158+0+DOC+PDF+VO//EN>

Criminal offenses	<p>The ECJ, in its judgment of 13 September 2005⁷⁹ states that the Commission can take measures in relation to the Member States' criminal law where the application of criminal penalties is an essential measure for combating serious environmental offences.</p> <p>A proposed directive in 2007⁸⁰ to establish a minimum of set of intentional and negligence based criminal offences when a dangerous occupational activity causes substantial environmental damage.</p>	
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APPENDIX 2 - NATIONAL REGULATIONS –

Company and directors liability ⁸¹		Lessons
Corporate criminal liability and collective action	<p>England: The company is criminally liable for misconduct and for subsidiary's conduct. It is civilly liable if it causes direct damage by fault or negligence. Alternatives to US-class actions exist through other collective actions. GLO⁸² or representative actions could be brought.</p> <p>France: The company may be criminally liable⁸³. It's civilly liable for fault and for its subsidiary's conduct. Only associations can bring collective action⁸⁴, such as consumer protection groups. Subject to conditions, associations can initiate civil proceedings on behalf of several shareholders who have suffered direct or indirect loss and for investors in the event of losses concerning securities.</p> <p>Germany: The company is not criminally liable. But it is civilly liable and for special administrative faults. The KapMuG Act in 2005 establishes sample proceedings in litigation arising from certain capital markets' transactions but doesn't allow class actions.</p> <p>Italy: The company is not criminally liable but civilly and administratively liable. There is no class action in spite of several draft bills in 2006.</p> <p>Netherlands: The company is criminally and civilly liable. The CSMDA (came into force on 1 August 2005) allows associations to represent injured parties in order to negotiate a settlement for the payment of damages.</p> <p>Spain: The company is not criminally but civilly liable. A number of groups already have the power to bring collective or class actions. Some consumer associations can bring a quasi-class action to claim damages on behalf of unidentified classes of consumers, or even indeterminate group members.</p> <p>Portugal: The company is not criminally but civilly liable and for administrative faults.</p>	<p>Corporate criminal liability is not always enacted in the EU Member States. Nevertheless, if class actions are not commonly allowed, EU legislation states that certain associations have the power to bring collective actions against companies. Moreover, shareholders, by way of derivative actions, can sue directors.</p>

⁷⁹ Judgment of the Court dated 13 September 2005, <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&newform=newform&Submit=Submit&jurcdj=jurcdj&docj=docj&typeord=ALLTYP&numaff=C-176%2F03&ddatefs=13&mdatefs=09&ydatefs=2005&ddatefe=&mdatefe=&ydatefe=&nomusuel=&domaine=&mots=&resmax=100>

⁸⁰ Proposal for a Directive of the European Parliament and of the Council on the protection of the environment through criminal law, http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0051en01.pdf

⁸¹ A FAFO survey on 16 countries analyses legal remedies for private sector liability of graves breaches in international law <http://www.fafno.liabilities/CCCindex.htm>

Freshfield Bruckhaus Deringer, European Litigation trends, March 2007, <http://www.freshfields.com/publications/pdfs/2007/mar28/18010.pdf>

⁸² Definitions: A US-Class action allow a large group of people (consumers) who suffered a common prejudice to bring a collective action. A GLO (group litigation order) deals with multiple claims involving common issues or fact or law; a representative action deals with claims defending the same interest.

⁸³ Article 121-2 French Criminal Code. Article 54 Perben II Act, 9 March 2004

⁸⁴ In 2006, several draft bills proposed to introduce class actions in France but without success at present.

<p>Director liability</p>	<p>England: Since the Companies Act 2006 (coming into force in October 2007), directors are required to have regard to the impact of the company's operations on the community and the environment. Shareholders may bring a derivative action⁸⁵ against directors. Victims and employees can sue directors for social or environmental damage.</p> <p>France: Shareholders have the right to sue directors on the company's behalf by way of an equivalent to the common law derivative action, and can bring an action for any personal loss. Third parties can sue directors for intentional misconduct independent from their duties.</p> <p>Germany: Shareholders can sue directors for personal damage or for damage to the company. Exceptionally, creditors may bring a direct claim against a director.</p> <p>Italy: Shareholders and third parties can sue directors for direct damage caused by the wrongdoings of an individual director. The board of internal auditors and the shareholders can sue directors for damages on behalf of the company, subject to minimum thresholds.</p> <p>The Netherlands: The shareholders cannot bring a derivative action against a director.</p> <p>Spain: Shareholders, subject to minimum thresholds can bring a derivative action, and with third parties, may bring a personal indemnity action for a direct damage.</p>	
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<p>Environmental and social liability and duties</p>		<p>Lessons</p>
<p>Environmental Liability</p>	<p>France: Draft Bill, 5 April 2007⁸⁶: This establishes a no-fault liability scheme for listed activities and a fault or negligence liability for any other activities if these have caused damage/ a threat to the environment in a Member State. The operator (except shareholders and banking houses) who controls, holds decisive economic power, over or holds a permit for such activity, should assume the costs of preventive and remedial measures, under a competent authority's control. Criminal penalties apply for natural and legal persons.</p> <p>Exemptions are available if the damage or the threat was caused by a third party or resulted from compliance with a compulsory order or instruction from a public authority; or if the operator is not at fault or negligent and if the activity is not likely to cause environmental damage according to the state of knowledge.</p> <p>Italy: Decree on Regulation on Environment, 3 April 2006⁸⁷: This establishes a fault or negligent liability scheme for the operator. There is no provision concerning the right to bring an action. The Minister of the Environment is the only authority competent for any legal compensation action.</p> <p>England: Directors may be sued by victims of environmental damage (Environment Protection Act 1990⁸⁸) or by employees in the event of a violation of the Health and Safety at Work Act 1974⁸⁹.</p>	<p>The geographic scope of these provisions is the key aspect to make multinationals accountability efficient beyond the EU territory. Although the Core Bill should apply to subsidiaries abroad, both the French and Italy bills do not concern this geographic scope.</p>


⁸⁵ Derivative action allows shareholders of a company to sue directors in the company's name for a failure of management: fraud, mismanagement, self-dealing and/or dishonesty

⁸⁶ Draft Bill on Environmental liability, 5 April 2007, <http://www.senat.fr/leg/pjl06-288.html>

⁸⁷ Decree on Regulation on environment, 3 April 2006, <http://www.parlamento.it/leggi/deleghe/06152dl.htm>

⁸⁸ http://www.opsi.gov.uk/acts/acts1990/Ukpga_19900043_en_1.htm

⁸⁹ <http://www.hse.gov.uk/legislation/hswa.pdf>

<p>Reporting obligation</p>	<p>France: Article 116 NRE Bill, 15 May 2001⁹⁰: the quoted company should provide information about how it's taking in to consideration social and environmental consequences of its activity. This report should contain information on subcontracting relationships, how the foreign subsidiary companies are taking into consideration the environmental and social impacts of their activities, and preventive and remedial means in the event of environmental issues. Administrators may be liable for non-publication of the report.</p> <p>The geographic scope of this information should mirror the geographic scope of the consolidated financial reports, which concern all the consolidated entities.</p> <p>England: CORE Draft Bill, 19 June 2003⁹¹: Make provision for certain companies to produce and publish reports on environmental, public health and safety, sustainable development, employment, human rights and consumer protection. A parent company of a corporate group should be liable to pay compensation, subject to several conditions, in the event of damage caused by a subsidiary abroad.</p>	
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⁹⁰ <http://www.legifrance.gouv.fr/WAspad/UnTexteDeJorf?numjo=ECO0000021L>

⁹¹ <http://www.publications.parliament.uk/pa/cm200203/cmbills/129/2003129.pdf>